AUTOMOBILE FINANCING

BY

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This subject is broad enough to permit a variety of presentations. In this paper it is considered generally, not with an elaboration of statistical analyses, but rather in a way likely to be most interesting to men whose contacts with it are indirect rather than specific.

Time sales, or arrangements for purchase under deferred payments, have a long history in financing systems. The application of such plans to automobiles is comparatively recent. A brief statement of the causes which led to this application will not be out of place.

In the beginnings of the automobile industry, which is still youthful, most of the manufacturers did not have financial strength. Dealers in the early days gave but little time to this enterprise and still placed their main reliance for support on the bicycle shop or some other small business which was more dependable as a source of living income; financial strength was notable chiefly by its absence. In those days an automobile was regarded as the highest type of luxury, the purchase of which was considered only by people distinctly well to do. One had to be eccentric to own an automobile in those days.

Following the emergence of the industry from its purely experimental state, there was a gradual development of mechanical process. As this went on and handwork decreased, it was soon apparent that an increase in production would bring more than a corresponding decrease in cost. Naturally many minds were engaged on the question of utilizing this potentiality.

It was clear that to attain substantially larger production prices must come down to a point where they would be within reach of a much larger potential purchasing group. But it was equally clear that the financing of such an increased production would place an insupportable burden on a financing structure already weak. Momentarily it appeared that a vicious cycle had

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been established. As usual in such cases, men began to feel around for a way out.

It did not seem that the manufacturer could supply the need because he required for essential expansion and normal working capital more than he could command. It was hard to see how the dealers could supply the required arrangements because they were already extremely hard put to it to carry a minimum stock in trade. Quite apart from the possibility of financing a larger production, both manufacturers and dealers faced another problem already a contention between them, namely how to care for the dull season, which, during the days when the open car prevailed, was most embarrassing to all parties of interest. The dealer had so many problems of his own that it was quite beyond his ability to give aid to a purchaser who perhaps could really afford a moderate priced car, but, for one reason or another, did not find it practical to pay for it at the moment of purchase.

In these circumstances, and over a considerable period, all sorts of expedients were tried. Many of them failed. Gradually and naturally, special agencies for automobile financing came into being. As the business progressed through its early stages, it gained many elements of strength. A considerable element of dependability and standardization came into play, and it became practical for banks to take a larger part than they had been willing to theretofore. In the course of the natural developments of this period, the so-called finance company came into play. As a natural evolution, the industry worked in to the present practices of automobile finance.

There are, of course, infinite varieties in the different stages of present-day automobile financing. It will suffice, perhaps, to give a broad outline of the practices generally in effect.

Most manufacturers today are relieved from financing a car when they have completed its sale to a distributor. They are left free to utilize all of their funds in manufacture and in carrying their product to the point of first sale. They are able to confine their main thought and energy to problems substantially similar to those encountered by most manufacturers. Some, however, have seen fit to interest themselves in the later stages of financing, either through subsidiary companies designed for this purpose, or by an arrangement with some finance company whereby the latter will offer some special plan to the dealers of this particular manufacturer.

It is comparatively rare today for the dealer to concern himself with financing beyond completion of the secondary sale. Generally speaking, he gets back his investment and his profit when he sells a car. Up to this point, it falls to him to arrange the financing from the moment he purchases cars from the manufacturer. In some instances he carries the burden entirely with his own funds. More often he borrows either from a bank or a finance company, either on his unsecured credit or by pledge of the cars, or by both methods. The loans against cars take various forms, but in almost every instance require the dealer to provide a percentage of the cost price. Sometimes the cars involved in such loans are lodged in public warehouse, but in other instances are carried on the dealer's floor. The dealer's capital, therefore, is used both for his ordinary working capital requirements and to provide the equity in the cars against which he has borrowed.

The dealer knows that the bulk of the people who will purchase cars from him will want a fair amount of time in which to complete payment. He, therefore, makes an arrangement either with a bank or finance company, so that when he completes a sale, they will help the purchaser to pay him the full sales price of the car. When this has been done in any given case, the dealer is enabled to pay off his loan, restore to his general funds the amount he has had tied up in the car, and to obtain his profit in cash.

The bank or finance company extending the so-called "consumer credit" naturally has certain rules which they require the potential purchaser to meet. The financing agency is concerned with the ability of the purchaser to consummate payment, because otherwise the car will revert to them, thus bringing trouble and possible loss. The agency is also concerned with minimizing the chance of loss in the event repossession becomes necessary, and protects against those possibilities, first by requiring a substantial "down payment," and second, by limiting the period within which payments must be completed.

Their object is to have a combination arrangement on these two points which will leave a value in the car at all times at least equal to the amount unpaid on the purchaser's note. It is perhaps unnecessary to remark that these principles are sometimes deviated from, and even when applied in good faith, do not always produce the desired result.

From the standpoint of banks and finance companies which operate in this field of financing, there are but comparatively few fundamental principles of operation with which they must constantly concern themselves. First of all, the financing agency is selective as to the make of car which it will finance, giving regard to its standing, popularity, wearing qualities, used car price, depreciation, etc.

In the second place, the financing agency is concerned to have their plan one which places a responsibility on the dealer. Otherwise, he is encouraged to make sales without regard to the purchaser's ability to pay. Various devices are used to secure this point of protection such as dealers' endorsements, agreement to repurchase the car if it is not paid for, arrangements whereby the dealers' profit, or part of it, is withheld until payment is completed, etc. Naturally, the financing agency gives consideration to the financial resources of the dealer, but it is perhaps rare when these are sufficient from a protective point of view, so that generally reliance is placed on some other feature of the plan.

A point of paramount importance is the credit or ability of the purchaser to pay. There is no easy way to picture the particular considerations which must be present in a satisfactory risk. A carefully managed agency, however, makes rather thorough inquiries as to the purchaser's standing in his community or neighborhood, his reputation for steadiness and honesty, his employment and the wages he receives, as well as collateral information such as ownership of property, etc.

Finally the agency is concerned with the amount of the "down payment" and the length of period over which the payments are to be made. Their object here is to have the owner possess at all times such a substantial equity in relation to value that he will strive mightily before giving up his claim to the car. They are almost equally concerned that the combination of "down payment" and instalments in hand at any time shall cover at least approximate depreciation which would be measured against the car in the used car market.

There are, of course, other considerations of importance to the financing agency. Enough has been said, however, to indicate the main principles by which the soundness of a given instalment plan may be measured. It is rare indeed to find a record where these considerations have had full weight and failure recorded. Almost invariably if cases of trouble are investigated, it will be found that the causes lie in the neglect of, or departure from, one or more above mentioned principles.

There are, of course, forces at work most of the time which tend to have a pull away from sound principles. The dealer, in his concern to make profits, is apt to pay but little attention to the credit worth of the potential purchaser. Finance companies have grown up and spread out so rapidly that their local organizations have oftentimes been weak and have failed to give the applied local supervision and service which is peculiarly essential in this business. As in any other attractive new business, many finance companies have sprung up, not always with sound management, and, naturally, an intense competition has been developed, with the usual experience that some began to offer terms which temporized with safety. At the height of this development, inadequate "down payments" were required, and too long a period allowed for payments, with the result that the owner made but little effort to continue to hold the car, presenting the vehicle to the company with a balance due on it greater proportionately than the depreciation which they had anticipated. Numerous companies in the haste of financing neglected the investigation of the individual's credit, with results naturally to be expected in such circumstances.

Experiences of the type just mentioned are not unique to the automobile financing business. Their equivalents are to be found in the records of practically all other lines of enterprise. Apparently the peak of these difficulties is quite well behind us. The troubles have been real, and in some cases have produced substantial loss. They have, however, brought their own corrective, and it is probably accurate to say that the automobile financing business generally is on a more conservative plane today than it has been at any time in its comparatively brief existence.

With the development which has been broadly traced the automobile business itself has had an enormous expansion. It is hard to escape the conviction that perhaps the largest single reason for this industrial growth is the financing system which is related to it. Out of the comparatively easy financing grew a tremendously larger volume and out of that came lower prices permitting general purchase. The retail value of automobiles sold this year will probably be something like eight times that of those sold in 1913, despite the fact that automobile prices generally have gone down perhaps 30 to 40% between the years mentioned.

Out of this growth has come one of our leading industries employing directly and in accessory and supply lines a veritable army of people. A large part of the product of a number of our basic industries goes into the automobile field. It is probably not inaccurate to say that a continuation of these conditions is dependent in large measure on the automobile financing methods which we have just discussed.

The comments which have just been made apply to this caption, Economic Consideration, but there are other considerations which require mention. As with every other great development, the building up of automobile financing has brought evil as well as good. It is difficult, however, to avoid the conclusion that the net effect has been beneficial.

It is sometimes charged that the development of automobile financing has impinged upon our national thrift. An examination of the ordinary measures does not give warrant for this conclusion. The deposits in our various banks, particularly savings banks, are greater than ever before, and the growth in the number of depositors has been in keeping. I am told that there are now in this country about four times as many savings bank depositors as there were in 1913, and the deposits have gone up more than 200% since that time. Figures on life insurance do not reflect cause for alarm; I believe that the life insurance now in force is at least five times that in existence in 1913. There does not seem to be any marked reduction in the number of persons buying and owning homes.

On the other side, we find wages and salaries paid out by industries enormously greater than they were before the automobile development attained large size, and we find both average wealth and average income per capita figures show commendable increases. In part at least, these developments are undoubtedly due to the marked increase in production which has come about in relation to the developments which we have discussed.

There is probably very little realization of the part that the automobile has played in the opening up of our country, and particularly in our suburban developments. The advantages to what we may term our national health are probably just as great as those which have come in purely material things.

Approximately three-quarters of all new cars are sold on instalments. This leads in a good year to perhaps two billion of instalment paper, but it should be realized that this amount is never outstanding at any one time. The average debt will run about half of the total paper. Furthermore, the average time that the average debt has to run is, say five or six months. These points are made in relation to the fears often expressed as to the effects of an industrial depression on automobile financing.

All in all, there is no reason for doubt that the development of automobile financing has brought benefits measurably greater than its faults. If it is held to sound principles, there appears to be every reason why it should contribute large benefits in the period ahead.

(EDITOR'S NOTE: *At the* conclusion *of his* address Mr. Hunter *invited the* members to ask questions. The following is a transcript of the discussion.)

Q. May I ask a question about the General Motors Company? Do they have any agreement with the General Motors Acceptance Company as to the repossession of cars?

A. They have an agreement with dealers. If he saw fit a General Motors Dealer could make his financing arrangements through some other companies. They are not obliged to go to the General Motors. It is a very sound plan. Naturally most dealers take it.

Q. Would General Motors Company refuse an application from their dealers to finance?

A. I never heard of such a case. They depend on their dealers to inquire as to the credit of the purchaser. That is the thought they try to keep foremost in the minds of the dealers. I think they have done very well in having a sound standard of credit. They don't accept the word of the dealer alone. They, themselves, investigate. That is of course a very conservative way to do business.

Q. Is the General Motors Acceptance Corp. a different concern from the General Motors Company?

A. Yes.

Q. General Motors Acceptance Corp. is simply a credit company and controls the business?

A. Right. They also have an arrangement where they set aside a certain percentage of the business they handle, I think 1½%, for the benefit of the dealer. They make quarterly payments.

The dealer has credit kept constantly in his mind. If things don't go through he has to take these things back. That is not at all pleasant for anyone.

Q. Are loans made through a financing company almost without any security except the car?

A. A man might borrow direct from a bank if he has any other property. They have simple rules and ask people to follow them out. They can borrow money from banks because it is cheaper. Of course when you buy a car on instalment, you pay more money for that accommodation. The Finance Company has to do extra booking. The bank knows you. There is about a $1.50 expense on every car investigation for every contract. They have to make a complete set of records for small transactions as well as large ones. They have to handle insurance policies. They have to make complete bookkeeping records. They have to send you out a notice of your instalment. Sometimes it is 12 notices for 12 payments. Very often they have to remind you to pay your money when you owe it. They have to send a man to get it if you don't pay after these notices. They exact a fee, if they can. If that fails to get your money then they have to chase you to get your car. Sometimes they have to chase, too. They have to have a large staff of lawyers to take care of the legal work. They sometimes have to bring a car many miles from where they find it. They may have to recondition that car and they may have to repaint it. They may have to take out dents or have the engine repaired. Then they have to maintain a used car sales agency to sell these cars. There is a great deal of bookkeeping entailed. Naturally the bank has to do very little. If you wish to borrow $1,000 for the purchase of a car you go into the bank with perhaps 10 shares of Amer. Tel. & Tel. stock. They have at all times something that they can sell for more than they owe you. There is occasion for them to charge very high rates.

Q. Suppose you have a good-sized automobile dealer, could he handle his own financing cheaper?

A. Some do, and some don't. There are several reasons. In the first place these men are in that business because their primary ability is along sales lines. They are not as good on financing as they are on selling. Another reason is that most of the automobile manufacturers very thoroughly discourage their dealers from doing the financing. They think, and wisely, that if the dealer is all mixed up on financing, the work he should be doing on sales would go into financing work. Some of the large manufacturers practically insist that dealers sell cars and get out of the financing end. Hardly any dealer has the law of average work for him like a financing company in getting credit results. Dealers don't usually do their own financing work.

Q. Does Ford do his own financing in this part of the country?

A. Ford dealers make their own arrangements. They are free to go wherever they want to.

Q. What happens to all the old used Ford cars?

A. Used cars of all descriptions move South. I don't know if any of you men have noticed it. Some time or another one asks himself, "What becomes of these old Fords?" The further South you travel, the more you will find. By the time you get down to the Andes the original Ford will be found there.

Q. Is there any published information regarding default in payments?

A. Most figures we have are conflicting. Some are issued by the National Association of Financing Companies. Remember this, the business is a very young industry. You haven't got dependable statistics yet. They will vary materially. They have been affected by variations in employment and other causes. This thing is perfectly plain, the poorer the plan the larger the repossessions.

Q. What is the effect on auto financing of new models coming out?

A. Financing companies always have that in mind. They protect themselves against it. An owner who has bought a car just before a new model is announced has such a large stake in it that he is of course unhappy, but he isn't going to give it up. Buick back in '23 brought about almost a revolutionary change. Their older model was a good looking and good working car and the owners did not give them up because of the new model just for the same reason as mentioned above. Depreciation on the older models was large but people didn't throw those cars away. Generally speaking, a company or bank is watching that sort of thing all of the time.