

HIRE-PURCHASE

NOT so many years ago time-payment finance was surrounded by an aura of dubious respectability. But the entry of the Commonwealth Bank and of two of Australia's leading trading banks into the field of hire-purchase—a territory they have been studiously careful to avoid—indicates that it has now become an indispensable and respectable part of the modern machinery of credit. The well-publicised activities of several large companies specialising in this form of finance have recently focussed public attention on the vast scale which it has assumed. It has penetrated more deeply into the fabric of the business structure than is generally appreciated and is widely used, not only by ordinary wage and salary earners, but also by farmers and small businessmen for the purchase of capital equipment.

In its broadest sense time-payment may be said to cover all credit extended by financial institutions and retailers under which the purchase price of goods sold (including interest) is repaid in instalments over a period. The predominant form of this type of finance is hire-purchase—indeed, time-payment, in the trade meaning of the term, is now mainly confined to clothing, furniture and drapery.

In the popular mind, hire-purchase is usually associated with the purchase of consumer goods such as motor cars for private use, radios, refrigerators and a wide range of personal and household commodities. But producers' goods are of equal importance—motor trucks and buses,

farm implements and tractors, industrial plant, commercial refrigerators and motor cars used for business purposes, all come within the scope of hire-purchase.*

History:

(i) U.S.A.:

The roots of instalment finance go right back to the beginning of the last century to the difficulties experienced by the American furniture trade—one of the first handicraft industries to turn to factory production—in disposing of its output. "Time to pay" was the obvious answer to creating a mass market for furniture among the lower income groups. Later instalment credit spread to such diverse fields as sewing machines and encyclopaedias. Initially financed by the sellers, it was not until 1905 that the now familiar finance corporation made its appearance and assumed responsibility for the financial burden of instalment purchase transactions.

The really big break for hire-purchase came with the cheapening of the motor car before World War I when the manufacturers, like their predecessors in the furniture trade, began to switch from custom-built products for cash patrons to assembly line output for the masses. The selling emphasis changed from the accumulated past savings of the buyer to his future potential income. A great range of electrical appliances and wireless sets was added to hire-purchase facilities in the 1920's. By

*The purchase of a house on terms is not regarded as instalment credit.

1929, two out of every three cars in U.S.A. were sold on terms, and instalment credit for consumer goods, including cars, had reached 3¼ billion dollars, an amount equal to about 4% of the total of all personal incomes.

The trend of instalment credit in U.S.A. follows closely the level of expenditure on durable goods. It fell away sharply during the depression with the collapse of the durable goods market and only regained pre-depression proportions in the early years of the war before Pearl Harbour. After Pearl Harbour factories were diverted to war production and hire-purchase terms were tightened. From a new peak of 6% of personal income in 1941, instalment credit dropped to 1½% by 1945. After the war it took five years to get back to 1941 levels; goods were scarce and people were able to pay cash from pent-up savings. Then came the Korean War and hire-purchase curbs were imposed as a counter to inflation. These restrictions were removed in May, 1952, and a sharp upward burst in spending has taken the level of instalment credit to just short of 8% of personal income. Some down-turn is now anticipated because of a slackening in sales of motor cars and durable goods.

(ii) *United Kingdom:*

Little data is available on the extent of hire-purchase in the United Kingdom. Before World War II the British Hire-Purchase Traders' Association estimated that 4 million agreements were being entered into annually and that instalment agreements accounted for half of all sales of cars and furniture. The war was

even more severe on hire-purchase activities in United Kingdom than in U.S.A. But it has staged a remarkable recovery in the last three or four years; 75-80% of all furniture sales in United Kingdom are now financed by instalment credit and about half of all radio sales and a third of sales of television sets. However, the absence of any great volume of motor car sales on the domestic market has severely restricted the extent of hire-purchase finance in Britain as compared with U.S.A. Also manufacturers and bankers, unlike their American counterparts, appear to have been slower to cultivate the mass market, and this in itself has narrowed the influence of hire-purchase in the United Kingdom.

(iii) *Australia:*

Hire-purchase credit facilities have been long-established features of retail trade in Australia, particularly in furniture and pianos. The subsequent trend followed the American pattern—rapid expansion during the motor car and electrical appliances boom of the '20's; stagnation in the '30's; a short-lived recovery followed by war-time frustration. However, after the war, as goods became available, hire-purchase finance was rapidly extended to the limits set by controls over bank advances and capital issues. In Australia today about 30% of cars, 50% of furniture and 60% of refrigerators are sold on terms. With the complete removal of capital issues controls, and modifications in bank advance policy, ample funds are becoming available to meet hire-purchase demands.

The Structure of Hire-Purchase Finance in Australia

Following the American pattern, responsibility for the financing of instalment purchase in Australia has largely passed from the trader selling the goods to an intermediary known as a finance, discount, acceptance or credit house. This organisation finances the transaction principally by either discounting the note signed by the purchaser or by paying off the seller and directly contracting with the purchaser for repayment. According to a survey conducted in 1950/51 by Professor Arndt, of Canberra University College, and his colleague, Mr. Shrapnel, the Commonwealth Bank and nine large finance companies accounted for 51% of all hire-purchase and time-payment transactions; 27% went to a number of smaller finance concerns; and 18% to department stores, car dealers and other retailers conducting their own instalment credit business. The remaining 4% largely consisted of instalment terms extended by gas and electricity undertakings on sales of stoves, refrigerators and other appliances.

The Commonwealth Bank, which has been financing hire-purchase by industrial users since 1945, wrote business during 1952/53 amounting to £15 million to 23,000 hirers covering a broad range of industry. A large proportion of hirers were primary producers buying tractors and farm machinery. So far only two trading banks have interested themselves directly in hire-purchase. One bank has established a special department whilst the other has acquired a substantial shareholding in a recently floated finance company with the object of facilitating provision of hire-purchase at its

branches throughout Australia. This contrasts with U.S.A. where over 40% of all instalment credit is handled by the commercial banks. Interest charges on hire-purchase agreements vary widely according to the status of the lender or the nature of the article. Lowest rates are on new cars and trucks—4 $\frac{3}{4}$ % on the initial debt by the Commonwealth Bank and 6 $\frac{1}{2}$ % by the larger finance companies. As the debt is reduced, the interest is still payable on the original amount and consequently the actual rate rises progressively.

Instalment Credit in U.S.A. and Australia:

Some conception of the magnitude of instalment credit in Australia may be gained by comparing it with the birth-place and largest user of hire-purchase, the U.S.A. However, because of the lack of comprehensive statistical information on hire-purchase in Australia, any comparisons must necessarily be of the crude variety.

U.S. data is available for instalment debt outstanding on consumer goods, but no statistics can be found for producer goods. Similar estimates for Australia, excluding producer goods, have been compiled from a variety of sources. The comparison is set out on the opposite page.

For obvious reasons the magnitude of instalment credit extended on motor cars is very much greater in the United States than in Australia (3.6% of personal income in the U.S.A. as against 0.8% in Australia). However, with other consumer goods the discrepancy is not nearly so marked (figures for 1953—U.S.A. 2.0%, Australia 1.4%) and indeed,

**HIRE PURCHASE DEBT OUTSTANDING ON CARS AND OTHER GOODS
PURCHASED FOR PERSONAL USE IN U.S.A. AND AUSTRALIA**

	1939	30th June 1945	1951	31st December 1953
U.S.A.—Billion Dollars				
Cars	1.5	0.5	6.3	10.3
Other Consumer Goods	1.6	0.8	4.3	5.6
TOTAL	3.1	1.3	10.6	15.9
Australia—Million Pounds				
Cars	4.1	0.1	20.8	30
Other Consumer Goods	8.0	3.7	33.7	50
TOTAL	12.1	3.8	54.5	80
U.S.A.—Percentage Personal Income				
Cars	2.1	0.3	2.5	3.6
Other Consumer Goods	2.2	0.5	1.7	2.0
TOTAL	4.3	0.8	4.2	5.6
Australia—Percentage Personal Income				
Cars	0.6	—	0.7	0.8
Other Consumer Goods	1.1	0.3	1.2	1.4
TOTAL	1.7	0.3	1.9	2.2

Sources—U.S.A.: Federal Reserve Bulletin. The figures are not comparable with earlier data quoted in this article since repair and modernization loans and personal loans are excluded. The data on cars may be slightly overstated relative to Australia because of the inclusion of personal loans on the security of cars under this heading in the U.S. figures. It is not possible to ascertain to what extent Australian banks find money for this purpose.

Australia: Hire Purchase Report 1941; Economic Record, May, 1953; Commonwealth Statistician's Survey of Hire Purchase Business of Finance Companies, published records and other data from individual companies and the Commonwealth Bank.

as the table shows, has been greatly narrowed since before the war.

A great deal of caution is necessary in interpreting these figures. It should not, for instance, be assumed that because the U.S. proportion is substantially greater than Australia there is considerable scope for the extension of hire-purchase in this country. The fact that in America per capita incomes (in real purchasing power) are over twice as high as in Australia, means that the average American is able to apply a higher proportion of his income to purchases on time-payment without crossing the line of financial prudence. For example, if we take the

average income of the ordinary American worker as £30 a week (after tax) and he applies 10% to time-payment purchases, he still has £27 to use for his other needs. On the other hand, if an Australian with an average income of say £15 were to apply 10% to time-payment purchases, the balance remaining for his other needs would be only £13/10/-. In short, a country with a high standard of living can afford to devote a greater proportion of its income to hire-purchase transactions than can one with a lower standard. U.S.A. has 59 radio sets and 28 motor cars per 100 people as against 29 radio sets and 12 motor cars for every

100 people in Australia. So long as this discrepancy in living standards persists, Australia can never be as fertile a field as the United States for hire-purchase transactions.

Hire-Purchase Finance and the General Credit Structure:

Hire-purchase companies obtain their funds from mortgage and short-run debenture loans, capital subscribed by shareholders and ploughed-back profits, and bank overdrafts. In the post-war period the banks provided about 50% to 60% of the lending resources of the larger finance companies. But recently, as capital issues controls have been relaxed, some effort has been made to shift more of the burden on to the shareholders and the investment market. 3% secured notes, redeemable at three-monthly intervals, have become a popular method of raising finance.

In common with British banks Australian trading banks have, in the past, been most cautious about entering directly into the hire-purchase field. This is in contrast to U.S.A. The interest of U.S. commercial banks in hire-purchase transactions was initially confined to lenders such as Giannini's Bank of America—now the world's largest bank—and the multitude of small local banks in American cities and towns. However, since the war, much of the hostility in traditional banking circles has waned and commercial banks today account directly for over 40% of all hire-purchase finance, compared with only 20% in 1939.

It is, of course, unavoidable that some bank credit will eventually find its way into the hire-purchase field.

During the post-war period Australian banks, while not lending directly for hire-purchase, were, in fact, devoting a considerable volume of funds to this form of finance through advances to finance companies and retailers. With the easing of controls over bank lending it was more or less inevitable that the banks should consider more direct participation in the hire-purchase sphere.

Advantages and Disadvantages:

Hire-purchase obviously leads to expanded business turnovers and thus to greater employment opportunities. By widening the range and class of buyers, instalment credit facilitates volume production of costly articles and hence may mean lower costs and improvements in quality. During their visits to America the British Productivity Teams discovered that instalment purchase tends to promote harder work by employees. American workers realise that with a little extra effort the dazzling appliances in the shops can be brought within the reach of the weekly pay envelope. The high standard of living of the average American is undoubtedly promoted by the fact that instalment buying enables and encourages him to buy the things he wants. Hire-purchase has also a special value for the smaller businessman as he is able to obtain capital for his business that would not be possible under ordinary overdraft conditions.

All forms of credit, however, should be used with circumspection, both by lender and borrower. In prosperous times hire-purchase could conceivably encourage the expansion of retailers' sales and of manufacturers' output to a boom level which

could prove a serious embarrassment should economic conditions change for the worse. It is in the interests of lenders—and it is also their responsibility—to keep an eye on the future and not to encourage unwise borrowing. Difficulties would clearly arise if consumers committed too great a proportion of their incomes to purchases on credit. By mortgaging their future earnings they run the risk of financial embarrassment in the event of illness, cessation of overtime earnings or loss of employment. Hire-purchase will continue to enjoy a good repute only so long as these principles are observed.

THE spectacular growth in hire-purchase and time-payment in Australia over the last two years needs careful watching. While the proportion of instalment credit sales to total sales in department stores in the United States has fallen since 1950, in Australia it has grown rapidly. Before the war, Australia was a long way behind the United States, but we have now caught up, and, if the present trend continues, it appears that we may even shoot ahead. Greatly increased costs, com-

bined with price control and sluggish stock turnovers have, it is true, forced the hand of Australian retailers. Various time-payment devices have been installed in order to boost sales. But with the sharpening of competition a few firms are breaking the golden rule that the first or deposit payment should be sufficiently substantial to make the hirer feel that the article is in fact his—even though it may not be legally. Firms indulging in this kind of business will, of course, have only themselves to blame if they incur subsequent losses.

Hire-purchase credit is a natural response to modern economic processes and, if rightly administered, contributes to the national good. But its inherent dangers should not be overlooked. It thrives on a rising level of incomes and its accompaniment, a low rate of repossession. Whether or not present trends in hire-purchase are to be regarded as healthy depends on one's estimate of the future level of incomes in Australia. If incomes do not continue to rise then sooner or later the upward trend in hire-purchase and time-payment facilities must come to an abrupt halt.

