

Use of Alternative Financial Services by the Poor

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Introduction

Low-income consumers tend to use the Alternative Financial Sector (AFS) more than other population groups. The AFS, as defined in this study, includes check-cashing outlets, rent-to-own stores, pawnshops, car-title loan companies, and fast-refund and post-dated check services. Thus, use of the AFS poses high costs on the population segment which can least afford the costs (Stein & Brown, 1988; Swagler, Burton, & Lewis, 1995a, 1995b; Taterka, 1987). If the cost of these services is high, then why are low-income consumers using them?

The purpose of this research was to answer this important question. Aspects of the AFS that were examined are: (a) types used, (b) reasons for use, (c) knowledge of cost, (d) frequency of use, and (e) use of money obtained through AFS. Brief descriptions of the services examined follow.

Regular check cashing is available at check-cashing outlets which cash personal, government, and pay checks. Consumers who use check cashing outlets usually do not have checking accounts at banks. Fees range from 1 to 10% or more, but vary by state and type of check (Swagler, Burton, & Lewis, 1995a, 1995b).

Rental-purchase agreements are credit alternatives offering ownership when merchandise is rented on a weekly or monthly basis for periods of 12 to 18 months. Although these "rent-to-own" programs stress low periodic payments, total costs are high. For example, a sofa which costs \$700 at a furniture store may cost approximately \$1,700 through a rent-to-own program. As long as the merchandise is rented, free repair or replacement is provided; but if customers fail to make payments on time, the merchandise is taken back, and no equity has accrued (Swagler, Burton, & Lewis, 1995a, 1995b).

Pawn-shop loans are credit alternatives which in some states include car-title loans. With the former, the customer leaves the merchandise (30-day loans are typical); with the latter, the customer surrenders the car title and a key to the car as collateral for the loan (loans of up to 90 days are the norm). The typical cost of a car-title loan is \$25 per month per \$100 borrowed. Consumers who obtain

loans at pawn shops encounter annual percentage rates above 300% (Swagler, Burton, & Lewis, 1995a, 1995b).

Refund-anticipation loans are offered by many income tax preparers and other outlets. Refund anticipation loans are not typically marketed as loans, but as "fast," "quick," or "rapid refunds." In fact, they are short-term loans through traditional financial institutions and are secured by the taxpayer's refund check. The cost of the loan ranges from \$29 to \$150, depending on the size of the refund (Swagler, Burton, & Lewis, 1995a, 1995b).

Post-dated checks, sometimes called payday loans, are unsecured loans from check-cashing outlets. The customer receives a loan against his/her paycheck and gives the check-cashing outlet a check dated up to two weeks later. Typical charges range from \$15 to \$20 for a two-week loan of \$100, with APRs ranging from 300% to over 500%. These are illegal in some states (Swagler, Burton, & Lewis, 1995a, 1995b).

It is evident that AFS costs are substantially higher than those for comparable services through the traditional financial sector. This is true across the entire range of services offered by the AFS.

Methodology

Sample, Data Collection and Analysis

Focus group interviews were used to collect data for this preliminary study. Questions asked are provided in the Appendix. The sample consisted of five focus groups of low-income persons who resided in local housing projects in Georgia. The groups were identified by the Director of the Housing Authority. The number of participants in each group ranged from 5 to 15. A total of 27 persons who had used one or more alternative financial services participated in the interviews. Data were collected in summer and fall 1995. As noted in Table 1, the mean age of the sample was 37.9 years. The majority were black (96.3%) and female (92.6%). Slightly more than half had incomes less than or equal to \$4,999 (51.9%). To examine low-income consumers' use of services in the AFS, the data collected were transcribed and summarized.

Table 1. Demographic Characteristics: Focus Groups (n=27)

Variable	Frequency	Percent	Mean
Age			37.9
Race			
White	1	3.7	
Black	26	96.3	
Gender			
Male	2	7.4	
Female	25	92.6	
Income			
≤ \$4,999	14	51.9	
5,000- 9,999	4	14.8	
10,000-14,999	3	11.1	
15,000-19,999	2	7.4	
20,000-29,999	1	3.7	
Above 30,000	1	3.7	
No Response	2	7.4	

Findings

The most widely used services in the AFS across all five focus groups were rent-to-own programs, check-cashing outlets, refund-anticipation loans, and pawn shops. Less frequently used were car-title loans and payday loans. Only one person had used a car-title loan, and payday loans were not used by anyone. The fact that payday loans were not used by anyone was not surprising given that very few of the respondents indicated that they owned checking accounts.

Reasons noted by respondents for using **rent-to-own programs** included bad credit, no down payment needed, cheaper per payment, and no credit check. "You can spend \$32 a month and get a house full of furniture," said one respondent. Another said, "They don't check credit—don't ask for anything. You just go in and maybe fill out an application, and they bring it on out to you."

Respondents said they used **check-cashing outlets** because (a) no ID was needed, (b) they had no transportation to the bank, (3) they had no bank account, and (d) outlets were convenient (unavailability of banks on weekends and at night). Respondents pointed out that check-cashing outlets stayed open until 7:00 or 8:00 p.m. Some reasons stated for not having a bank account included: (a) you can't

Swagler, R., Burton, J., & Lewis, J.K. (1995a). The alternative financial sector: An overview. *Advancing the Consumer Interest*, 7(2), 7-12.

Swagler, R., Burton, J., & Lewis, J.K. (1995b). The operations, appeals and costs of the Alternative Financial Sector: Implications for financial counselors. *Financial Counseling and Planning*, 6, 93-98.

Taterka, S. (1987, September). Rent-to-own: An expensive way to purchase. *Consumer Forum*, 1-4.

Appendix

Focus Group Questions

1. What do you do when you need money for something and you don't have enough on hand?
2. What might be the reason someone would go to an alternative financial service?
3. What do you usually do with the money you have borrowed?
4. Where do you go when you want to cash a check, send cash, file taxes, or any other AFS service?
5. Does the AFS charge more than the traditional financial sector?
6. How much more do you think they charge?
7. How often do you use AFS for these services?

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