

Pawnshops: A Choice for Consumers

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In 1988 it was estimated that \$1.723 million in loans had been made by the 6,853 pawnshops in the United States (Caskey, (1991). This was approximately 0.1% of the consumer credit extended in 1988. By 1991, the number of pawnshops in the U.S. climbed to 7,354 (Ravo, 1991), and pawnbrokers loaned \$3.3 billion, 1% of total consumer credit that year (Dinsmore, 1993). The increase in the use of pawnbrokers as a source of consumer credit has received attention in the popular press; however, there is a paucity of information and research on the business of pawnbroking in the United States (Caskey & Zikmund, 1990).

Pawnbroking, one of the oldest trades, is a form of secured lending that usually involves a small principal, a short term, and a high interest rate. It differs from small loan lending because the pawnbroker takes physical possession of the security pledged by the borrower when the loan is made. When the loan is repaid, the collateral is returned to the borrower. If the borrower fails to repay the loan within a set time, the pawnbroker is permitted to sell the collateral to recover the debt.

At the turn of the century in the United States, private pawnbrokers provided a standard means of moneylending for much of the nation because commercial banks did not do business with the middle class (Ravo, 1991). In the late nineteenth century, charitable organizations formed nonprofit pawnshops in several major cities in an effort to meet the credit needs of the working class. All of these pawnshops have closed, except the Provident Loan Society of New York which still flourishes, making loans at an annual interest rate of 23% (Hampson, 1988). Today, except for the Provident Loan Society, all pawnshops in the United States are for-profit operations.

Pawnshop Customers

Typically, pawnshop customers are high credit risks and cannot borrow on an unsecured basis. They usually require very small-amount loans that traditional lenders are unwilling to provide on secured basis (Caskey & Zikmund, 1990). The overwhelming

majority of pawnbrokers' customers are low-income individuals. Recently, however, pawnshops are attracting customers from all segments of society including contractors and small business owners who account for the majority of the large pawnshops loans. Pawnbrokers believe that these more affluent customers use pawnshops rather than less expensive commercial loans because they find pawnshops to be convenient and discrete. A loan from a pawnbroker offers minimal paperwork, privacy, immediate cash, and does not require a credit check (Jimenez, 1993).

The Business of Pawnbroking

Pawnshops often operate as one-stop financial centers for their customers. Brokers make loans, cash checks, sell money orders, provide notary services and bail bonds, and sometimes even handle utility bills and prepare income tax forms (Caskey, 1991).

Characteristics of Pawnshop Lending

Typically, pawnshop loans are (a) for small amounts, (b) for short maturities, (c) 100% collateralized by personal property, and (d) extremely costly (Caskey & Zikmund, 1990). Most pawnshop loans are for small amounts (\$40 to \$60), commonly for one- to three-month maturities. Many pledges are redeemed within one or two weeks (Caskey & Zikmund, 1990).

To prevent loss in the event of default, brokers lend a percentage of the resale value of the collateral, usually 40 to 60% (Caskey & Zikmund, 1990). Commonly pawned items include jewelry, electronic and photographic equipment, weapons and firearms, musical instruments, and art objects. When storage space is available, some pawnbrokers accept automobiles, recreational vehicles, and heavy equipment as collateral (Jimenez, 1993).

Pawnshop credit is extremely costly. Caskey (1991) found that interest rates on an average size loan of \$40 to \$60 varied from 0.5% per month (36% APR) in Pennsylvania to 20% per month (240% APR) in Oklahoma. Some states allow brokers to charge storage and insurance fees, which raises the effective price of the loan.

Regulation of Pawnbroking

In the United States, pawnbroking is regulated by state and local governments. While regulations vary from state to state, they follow a similar pattern. When a customer pawns an item, the terms of the loan contract are specified on a pawn ticket that includes identifying information about the customer and the item being pawned. The broker and customer each retain a copy of the ticket (Caskey, 1991).

Some states regulate the types of items that can be pawned. In Delaware, for instance, it is illegal for a broker to accept false teeth or artificial limbs as collateral for a loan. All states require pawnbrokers to file daily or weekly police reports listing items pawned and identifying the individuals pawning the goods (Caskey & Zikmund, 1990).

The regulation of pawnshop interest rates and other charges, such as storage and insurance fees, varies. In states, such as Illinois, Indiana, Oregon, Maine, Missouri, and Texas, which impose ceilings on pawnshop interest rates and fees, brokers often charge the legal maximum. In states that impose no interest ceilings, such as Alabama, Florida, Iowa, and South Dakota, interest rates commonly range from 18% per month to 28% per month (Caskey, 1991); and in states, such as Utah, where interest ceilings are prohibited, brokers set their own interest rates and loan fees based upon the prevailing trends in their locality.

The amount of time before a loan is in default, usually 1 to 3 months, is specified by the locality or state regulating the broker. When an item held as collateral is sold, some states require that the collateral be sold at public auction (Caskey, 1991).

Implications for Consumer Educators

Traditionally, consumer educators and counselors have emphasized that pawnshops should be a consumer's lender of last resort. The recent growth in the pawnbroking industry and the increased popularity of pawnshop credit is creating a need for financial counselors and consumer educators to include accurate and up-to-date information about pawnbroking when they teach about credit options. Such information should include the laws and regulations governing pawnbrokers in their state or locality, the costs of pawnshop credit, and

methods to translate costs to an annualized basis.

Consumer educators can use media stories about pawnbroking and pawnshop advertising from newspapers and the yellow pages of telephone directories to illustrate the different types of pawnbrokers and their merchandise and services. Students and workshop participants can comparison shop for credit by visiting a pawnshop and walking through the process of obtaining a pawnshop loan. A consumer educator might also draw upon the real-life examples of people who have used pawnshops to illustrate how pawnshops operate and what pawnshop credit costs.

References

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Note

Information concerning Illinois laws and regulations governing pawnbrokers may be obtained from the Illinois State Library, 300 South Second Street, Springfield, IL 62701-1796, (217) 785-5600. Educators in other states should contact their state attorney general.