International Review of Social Sciences and Humanities
Vol. 3, No. 2 (2012), pp. 214-229
www.irssh.com
ISSN 2248-9010 (Online), ISSN 2250-0715 (Print)

A Risk-Tolerance Paradox: Are Payday and Car Title Loan Customers Really More Risk Tolerant than Others?

Fred Fernatt
Ph.D. Candidate, Personal Financial Planning, Kansas State University,
312 Justin Hall, Manhattan, Kansas 66506 USA,
E-mail: cpacfp@k-state.edu

Sara Stolberg
Ph.D. Candidate, Personal Financial Planning, Kansas State University,
318 Justin Hall, Manhattan, Kansas 66506 USA,
E-mail: cfpphd@k-state.edu

Jaime Blue
Ph.D. Candidate, Personal Financial Planning, Kansas State University,
318 Justin Hall, Manhattan, Kansas 66506 USA,
E-mail: blue.jamie@gmail.com

John E. Grable
(Corresponding Author)
Professor, Personal Financial Planning, Kansas State University,
318 Justin Hall, Manhattan, Kansas 66506 USA,
E-mail: jgrable@ksu.edu

(Received: 2-4-12 / Accepted: 27-4-12)

Abstract

Payday and car title loan operations in the United States have grown exponentially over the past two decades. Such loans are normally for small amounts with short-term maturities and generally extended to borrowers facing liquidity constraints. Some borrowers may find that they are not able to repay these loans, which draws them into a spiral of ever increasing debt. By any measure, the interest rates charged are onerous. Given the high interest rates charged and potential significant negative outcomes associated with these loans, some assume that the risk-tolerance profile of borrowers is high. Results from this research indicate that borrowers view the positive loan attributes of payday and car title loans (e.g., fast and easy) as

outweighing potential risks and costs. This creates an interesting risk-tolerance paradox; namely, relying on high risk and cost loans should be an activity reserved for those with high financial risk tolerance, whereas existing evidence suggests that payday and car title loan borrowers tend to have a low financial risk-tolerance profile. This research helps address this puzzle. In this study, it was determined that the risk-tolerance of high cost borrowers was found to be lower than non-borrowers.

Keywords: Payday Loans, Car Title Loans, Risk Tolerance.

1. Introduction

The story is all too familiar. An otherwise responsible person finds herself behind on one or two bills. Maybe it is a utility bill or maybe it is a car payment. Regardless of the expense, the outcomes associated with not paying are significant. If she delays paying the utility bill, she runs the risk of having power shut off to her home. If she postpones the car payment she could lose her mode of transportation. After searching for other short-term lending alternatives she notes that her credit card is already near its credit limit. Social networks are a principal source of help for those who need money to deal with these types of emergencies but the amount needed to cover her expenses is more than she feels comfortable borrowing from friends and family (see O'Brien, 2012). Complicating this type of situation is the relative urgency of the circumstance. If she is like 15 million other Americans, she will choose a payday or car title loan to meet her short-term cash flow emergency.

According to Connor and Skomarovsky (2011), a payday or car title loan (PCTL) is a short-term cash advance that is typically repaid or extended on a weekly or two-week interval (monthly for car title loans). When making a payday loan, the lender accepts a postdated personal check or authorization to withdraw money directly from the borrower's bank account when the loan is due. Title loans are similar; however, rather than providing a postdated check, the borrower provides a set of keys and the title to his or her car as loan collateral (Zywicki, 2010). The PCTL industry started in the late 1980s, with marked growth since inception (Iowa Citizens for Community Action, 2011). The industry has exploded to a current volume of more than $30 billion in short-term loans on an annual basis. In the U.S., there are over 22,000 PCTL stores—more locations than Starbucks.

The use, costs, and outcomes associated with these types of loans are staggering. The average payday borrower takes out nine consecutive loans per year (Center for Responsible Lending, 2009). Even though the average loan amount is about $400, fees per loan range from $15 to $20 for each $100 borrowed, with fees assessed at the time of the cash advance (Stegman, 2007). The resulting national average annualized percentage rate for these loans is an astronomical 455%, with some borrowers paying as much as 1,000% per year (Connor & Skomarovsky, 2011). As an example of how costly these loans can be, Connor and Skomarovsky calculated that someone who borrows $300 for 14 days may end up paying back $775 in principal, interest, and fees. This is the reason the PCTL loan industry has been targeted as a form of predatory lending, as it focuses on providing loans to individuals who, once they have borrowed, are forced to pay high fees and expenses in a revolving cycle.

When viewed objectively, financial counselors and planners rightfully look askance at PCTL products. Given the costs, obligations, and potential negative outcomes associated with such loans, it is sometimes common for policy makers, traditional lenders, consumer activists, and researchers to assume that the risk-tolerance profile of those who borrow from PCTL providers must be relatively high. This is a reasonable conclusion. After all, who would voluntarily borrow money knowing that the real interest rate on the loan could exceed several hundred percent? Further, who would seek such a loan when other alternatives exist? When these questions are assessed using a cost/benefit analysis, the conclusion is that only highly risk tolerant consumers should borrow from PCTL providers.

The research reported here was undertaken to test the assumption of increased risk-tolerance and PCTL borrowing. Specifically, this paper answers the paradoxical question of whether or not PCTL borrowers have a higher financial risk-tolerance profile than consumers who have never taken out this type of loan. This paper extends the current literature by also showing what factors PCTL borrowers consider when deciding which lender to choose when faced with a short-term financial need.

2. Review of Literature

It is easy to shine a light on the PCTL industry and claim that unscrupulous lenders prey upon uneducated, gullible consumers who seek out these loans. Some believe that while payday loans are promoted as a way to deal with a sporadic financial emergency, most borrowers become ensnared in long-term, high-cost debt traps. It is common to hear that the predatory practices of payday loan providers results in increased financial stress among borrowers (Fox, 2009). However, the literature is not entirely supportive of this view.

Agarwal, Skiba, and Tobacman (2009) showed that the use of PCTL products almost always occurs as a result of liquidity constraints at the household level, not because of a loan enticement. It is important to note that over 50% of PCTL users possess at least one credit card (Elliehausen & Lawrence, 2001). This means that a large percentage of PCTL borrowers have an immediate alternative for a short-term loan. The problem is that among those who hold a credit card, only one-third pay more than the monthly minimum balance (Agarwal et al.). That is, the majority of those with an alternative line of credit tend to be maxed-out in terms of their credit limit.

The process leading to the use of a PCTL product begins when a consumer is faced with a financial emergency or contingency. When possible, these consumers turn to other short-term sources of liquidity, such as credit cards or family and friends. It is only when credit cards and other sources of short-term funding have been exhausted that the choice to obtain a PCTL is generally made. Agarwal et al. (2009) noted that PCTL borrowers not only face liquidity constraints, they also tend to incur persistent financial shocks that lead to money mismanagement. There was no evidence in their study that PCTL borrowers were, on the whole, financially illiterate. It appeared from their data that the PCTL borrowing decision was in many ways a rational choice at the time of the loan.

Lawrence and Elliehausen (2007) showed that borrowing at high rates of interest may occasionally be an optimal choice for some consumers. They used the consumption/choice

model (Hirschleifer, 1958; Juster & Shay, 1964) to characterize rational PCTL use being associated with a consumer preference for current consumption among consumers with low income and high real and/or perceived investment opportunities. The consumption/choice model posits that consumers typically purchase durable goods through a combination of borrowing and equity investment. When installment payments are employed, a consumer builds equity in the good over time, thus reducing the possibility of default. This implies a trade-off between equity investment and current consumption.

Consumers who do not wish to forgo current consumption generally must turn to unsecured sources of credit. One obvious choice is a credit card. A PCTL loan is another alternative. Given the lack of or low value of collateral, such loans tend to be more expensive. When faced with a financial emergency, limited sources of equity, and unsecured lines of credit, some consumers may rationally borrow from PCTL providers, often because they are either unaware or unwilling to seek other forms of borrowing.

Others have argued that the use of high cost sources of funding provides some consumers with a way to hedge their behavior. This is a form of rational risk taking. Katona (1975) and Lawrence and Elliehausen (2007) noted that often consumers prefer to borrow money rather than liquidate assets. They do this as a way to force themselves to budget, knowing that if they sell property they will be unlikely to repurchase the asset in the future. Not only would they not have the asset, they would likely still have an immediate cash flow need. Katona termed this phenomenon *pre-commitment*, which he defined as a self-imposed way to enforce financial discipline. There is evidence to suggest that some consumers obtain satisfaction using this approach. Lawrence and Elliehausen confirmed that 92% of borrowers feel that these PCTL lenders provide a useful service. Further, 75% of PCTL borrowers rate their level of loan satisfaction as either somewhat or very satisfied.

Although the use of high-cost loans can sometimes be seen as rational in an economic sense, this does not mean that PCTL borrowers engage in complete and unbiased information search activities. Risk researchers might argue that the high cost of PCTL borrowing implies that those who use these loans are highly risk tolerant, but it is just as likely, as noted by Lawrence and Elliehausen, that PCTL borrowers do not engage in intense information search. As a result, they subject themselves to high-risk outcomes because the loans themselves are relatively small in comparison to each borrower's household budget. That is, PCTL users may be engaging in a cognitive bias where they view the cost of a loan in a relative rather than an absolute sense. It is equally likely that PCTL consumers perceive their alternatives as being limited. As suggested above, PCTL borrowers typically have limited access to other unsecured lines of credit.

2.1 Factors Associated with PCTL Usage

Several demographic and socioeconomic factors have been examined in relation to PCTL borrowing. Unbanked African-Americans who are unemployed are all significantly more likely to use payday loans (Avery, 2011). Being unbanked refers to having no checking or savings account, which drives borrowers to use alternative financial services (O'Brien, 2012).

In the United States, overall, nearly 54% of African-American households, 43% of Hispanic households, 15% of non-Hispanic Whites are unbanked or under-banked. (FDIC, 2009)

Agarwal et al. (2009) found that the average PCTL borrower had lived in his/her current residence for just over five years as of 2009, was 37.15 years of age, female, and had a bank account balance of approximately $257. They also reported that typical PCTL borrowers earned just slightly more than $1,686 per month. Lawrence and Elliehausen (2007) found that the majority of PCTL borrowers tend to be married when they take out a loan. Nearly two-thirds of borrowers have children, and at least one-third of borrowers have some college education, with almost 20% of PCTL borrowers holding a four-year college education, compared to only six percent without a high school diploma. About 60% of payday loan borrowers report that they could not borrow elsewhere (Avery, 2011).

By default, those who use a payday loan must have a bank/checking account, whereas those who use title loans must possess a title to their automobile (Stegman & Faris, 2003). Clearly, while PCTL borrowers may be low-income customers, in other respects these borrowers tend to share a socioeconomic profile that places them above the riskiest borrowers (i.e., those who rely on pawnshops and finance companies). Most PCTL borrowers are known to cut their spending, seek a pay raise, or pay off their loans themselves in order to stay current with loan payments (Lawrence & Elliehausen). As a result, it is not surprising that only a few borrowers (approximately 20%) abuse these high cost loans (Lawrence & Elliehausen). Only four to six percent of borrowers default on payday loans (Avery, 2011). Some borrowers do get caught in the trap of spiraling debt because they are not able to fully retire the debt, which means they must renew the loan time after time. These borrowers often find themselves in worse financial shape than before first engaging in a PCTL. The result is an increased likelihood of declaring bankruptcy, becoming delinquent on a credit card, or delaying medical care (Fox, 2009).

Overall, PCTL borrowers tend to be credit constrained, but they also have bank/checking accounts, steady employment and income, and families (Stegman, 2007). From a lender perspective, these are factors which make promising consumers. PCTL borrowers tend to be financially responsible—although their access to unsecured credit lines is severely limited—and in a position to make payments on their loans. For many years, U.S. military personnel were a prime target market for PCTL providers. However, in 2007 federal legislation was enacted that forbid payday loans to active duty military personnel and their families. Interest rates charged to those in the military was also capped at a maximum APR of 36%. In response to these limitations, PCTL lenders have since turned their marketing attention to the broader population, with great success.

To date, nearly every PCTL study has focused on describing either the characteristics of borrowers or lenders. The PCTL loan industry has been identified as a profiteering venture that takes advantage of the working poor (Lydersen, 2001). Lawrence and Elliehausen (2007) noted that even if true—there is active debate on both sides of the issue—these lenders satisfy a loan demand by individuals traditionally underserved by the banking industry (Caskey, 2001).

A growing segment of the PCTL literature has been devoted to describing the characteristics of those who receive these short-term uncollateralized loans. Factors such as geographic location, socioeconomic status, occupation, race, age, and military status are commonly used in these studies (Gallmeyer & Roberts, 2009). It comes as no surprise that those who use

PCTL loans tend to exhibit a lower socioeconomic status. In terms of proportions, non-Whites take out PCTL loans to a greater extent. As this summary suggests, a great deal is known about the demographic profile of PCTL borrowers. Even more is known about the operations and profitability of PCTL providers. Prior literature also reflects that borrowers themselves have a relatively good grasp of the costs and benefits associated with the use of PCTL products (Caskey, 2001).

What is less well known are the reasons why some borrowers turn to PCTLs. The choice does appear to be driven, in large part, by liquidity constraints at the household level (Agarwal et al., 2009). Risk tolerance is a factor that may also be associated with loan choice. It is reasonable to assume that given the inherent riskiness of payday loans, in terms of potential interest costs and associated outcomes associated with default, those who take on PCTLs should exhibit higher risk tolerance than non-PCTL consumers. There is some related evidence to suggest that this assumption might be correct. Ding, Quercia, Li, and Ratcliffe (2011) used a sample of community reinvestment loans compared to subprime loans—those originated primarily by mortgage brokers to liquidity constrained consumers—to determine that borrowing choices help explain default risks. Consumers who were willing to purchase real estate with adjustable rate mortgages—a form of risk taking—were more likely to default on their mortgage loan.

It is interesting to note, however, that an exhaustive search of the *Proquest* database showed no research directly linking the financial risk tolerance of PCTL borrowers to the use of loans. This line of inquiry does not yet exist; however, there are theoretical reasons to hypothesize such a relationship. The mortgage literature provides an insight into the association between household borrowing decisions and risk tolerance. Storms (1992) noted that a family's choice of mortgage—fixed versus variable rate, duration of payments, etc.—is influenced by a number of factors, with risk tolerance being significant among these determinants. Households that exhibit low levels of risk tolerance (i.e., unwilling to engage in behavior with potential significant financial losses) search the marketplace for loan alternatives that reduce debt costs while locking in payment stability (Finke, Huston, Siman, & Corlija, 2005; Hogarth & Hilgert, 2002). Consumers with a higher risk profile often turn to holding high-interest loans and/or debt alternatives that possess non-trivial risks for reductions in income and increased demands on family resources (Godwin, 1999; Smith, Finke, & Huston, 2011). If it is assumed that PCTL borrowers are similar to others who borrow money, a similar pattern of risk tolerance should be observed in the payday and car title loan marketplace. The remainder of this paper describes the unique dataset and methodology used to evaluate the risk tolerance of PCTL borrowers in an effort to determine if those who use PCTLs are more or less risk tolerant than others and to determine other factors, beyond liquidity constraints, that might be driving consumers to PCTL providers.

3. Methodology

Data for this study were obtained from a sample designed to over-represent individuals who might be experiencing financial stress and likely to have taken a payday or car title loan as a way to meet immediate cash flow needs. Surveys were distributed in three counties in one

Midwestern U.S. state. The counties comprised over 500 square miles. The sample was generated from a list of water meter addresses in four non-contiguous cities within the counties. A proportional representation sample was used to select 1,000 addresses. Of these, 186 surveys were returned by the post office as non-existent addresses. Generally, these returns indicated that the locations were not residential (e.g., business), a vacant lot, commercial property, or an incorrect street location. Additionally, 108 surveys were returned as non-deliverable, typically because the location was vacant or the residents had moved. Of the 706 surveys that were delivered, 259 were completed and returned. As a way to increase response rates, individuals who completed the survey received $20 as a cash incentive after completing and returning the survey. This resulted in a useable return rate of 37%.

3.1 Risk Tolerance

The financial risk tolerance of respondents was measured using a 7-item scale developed by Grable and Joo (2001). Questions included: (a) I would prefer a sure gain of $500 over a 50% chance to gain $1,000 and a 50% chance to gain nothing, (b) Investing is too difficult to understand, (c) I am more comfortable putting my money in a bank account than in the stock market, (d) When I think of the word “risk” the term “loss” comes to mind, (e) Making money in stocks and bonds is based on luck, (f) In terms of investing, safety is more important than returns, and (g) The thought of taking a risk is exciting to me. Six response choices were provided for each item: (a) Strongly Disagree (1), (b) Disagree (2), (c) Not Sure, Probably Disagree (3), (d) No Sure, Probably Agree (4), (e) Agree (5), and (f) Strongly Agree (6). Scores ranged from a low of 11 to a high of 39. On average, respondents scored 22.58 (SD = 5.42) on the scale. The scale’s Cronbach’s alpha was $\alpha = .71$.

3.2 Use of PCTLs

Respondents were asked the following question to determine their use of PCTL products: “Have you ever received a payday or car title loan?” Responses were coded 1 for yes, otherwise 0. In this study, approximately 10% of respondents (N = 25) indicated having borrowed from a PCTL provider.

3.3 Control Variables

The choice of control variables in this study was made based on how similar studies have dealt with demographic and socioeconomic factors (e.g., Avery, 2011), as well as related research addressing other consumer borrowing choices (e.g., Smith, Finke, & Huston, 2011). The following respondent characteristics were controlled in this study: (a) years living in state of residence, (b) age, (c) gender, (d) financial knowledge, (e) marital status, (f) household income, (g) education, (h) racial/ethnic background, and (i) household size. Years living in the state, age, and education were coded in years as reported by each respondent. Gender was

coded 1 = male and 2 = female. Financial knowledge was measured by asking each respondent to indicate how knowledgeable about personal finances they thought they were compared to others. A ten-point stair-step response choice was provided, with 1 = lowest level and 10 = highest level. Marital status was coded dichotomously so that those who were married were coded 1, otherwise 0. Household income was assessed by asking respondents to report their usual monthly income over the past year from all sources, including public assistance, on a before tax basis. The natural log of the variable was calculated to assist in data assessment and interpretation. Racial and ethnic background was coded dichotomously so that those who were non-Hispanic White were coded 1, otherwise 0. Finally, household size was assessed by asking respondents how many people lived in their household and shared income with the respondent.

3.4 Data Analysis

A combination of statistical methods was used to evaluate the risk tolerance-PCTL relationship. Initially, a mean comparison was made to determine if a statistical difference in risk-tolerance scores existed between those who had used and those who had not used a PCTL product. This was followed by a binary logistic regression analysis using the independent variables and financial risk tolerance to predict PCTL borrowing. It was hypothesized that if risk-tolerance differences were noted in the bivariate assessment, these differences should hold in a multivariate analysis. Finally, comparisons of PCTL borrowers and non-borrowers were assessed using a combination of parametric and non-parametric tests as a way to further explain PCTL borrowing behavior.

4. Results

4.1 Demographic Profile of Respondents

Respondents tended to be long-term residents of the state and community, with a mean reported years of 25.42 (*SD* = 20.34). No significant differences were noted between PCTL borrowers and others. The average age of respondents was 40.94 years. Although PCTL borrowers were nominally younger (*M* = 35.80, *SD* = 14.27) than non-PCTL respondents (*M* = 41.50, *SD* = 17.88), no significant differences were noted. Although approximately 80% of PCTL borrowers were female, no significant gender differences were noted. Statistically significant differences between PCTL borrowers and others were noted in terms of financial knowledge. The mean knowledge score for the sample as a whole was 5.98 (*SD* = 2.30); however, PCTL borrowers reported a knowledge level closer to five (*M* = 5.08, *SD* = 2.16), whereas non-PCTL respondents reported a 6.08 (*SD* = 2.30) level of financial knowledge. Both groups were similar in terms of marital status. On average, 59% (*SD* = .49) of respondents were married. Household income, on average was 7.88 (*SD* = .75). Income level was also similar between PCTL borrowers (*M* = 7.60, *SD* = .70) and others (*M* = 7.91, *SD* = .75). Significant education differences were noted. The sample as a whole reported 15.05 (*SD*

= 3.34) years of education; however, PCTL borrowers reported 13.60 (*SD* = 4.52) years, whereas others reported 15.21 (*SD* = 3.16) years of formal education. In this study, 82% of respondents were non-Hispanic White. This percentage was similar to non-PCTL respondents (*M* = .84, *SD* = .37) and significantly different from PCTL borrowers (*M* = .69, *SD* = .48). Comparable to what has been reported in the literature, a high percentage of non-Hispanic Blacks, Hispanics, and others of differing racial and ethnic backgrounds were found to be PCTL borrowers. Non-Hispanic Whites made up only 68% (*SD* = .48) of PCTL borrowers in this study. Finally, household size between PCTL borrowers (*M* = 2.68, *SD* = 1.55) and others (*M* = 2.19, *SD* = 1.25) was similar to the sample average (*M* = 2.24, *SD* = 1.29). Table 1 shows the demographic and socioeconomic profile of respondents as a whole and by payday loan category.

Table 1 Demographic and Socioeconomic Profile of Respondents

	Whole Sample		*PCTL Borrowers*		*Non-PCTL Borrowers*		
Characteristic	*M*	*SD*	*M*	*SD*	*M*	*SD*	Sig.
Risk Tolerance	22.58	5.42	20.28	4.93	22.83	5.42	.02[A]
Residence Length	25.42	20.34	21.64	20.46	25.82	20.33	.33[A]
Age	40.94	17.62	35.80	14.27	41.50	17.88	.13[A]
Gender (1 = Female)	1.64	0.48	1.80	0.41	1.63	0.49	.12[B]
Financial Knowledge	5.98	2.30	5.08	2.16	6.08	2.30	.04[A]
Marital Status (1 = Married)	0.59	0.49	0.54	0.51	0.59	0.49	.67[B]
HH Income	7.88	0.75	7.60	0.70	7.91	0.75	.06[A]
Education	15.05	3.34	13.60	4.52	15.21	3.16	.02[A]
Racial/Ethnic Background (1= Non-Hispanic White)	0.82	0.38	0.68	0.48	0.84	0.37	.05[B]
HH Size	2.24	1.29	2.68	1.55	2.19	1.25	.07[A]

[A]Statistical significance assessed with t test. [B]Chi-square statistical significance test

4.2 Key Findings

Table 2 shows that the working assumption that PCTL recipients are more risk tolerant than others cannot be supported. The data indicate that those who had received a PCTL reported having a *lower* willingness to engage in a financially risky behavior than others. The difference, when measured in a bivariate fashion, was statistically significant. Given the disproportions in sample sizes between the two groups, a Mann-Whitney test was used to confirm these findings. The difference in risk tolerance was found to be statistically significant ($z = -2.48$, $p < .01$)

Table 2 Mean Difference in Financial Risk Tolerance based on PCTL Status

Group		*N*	*Mean*	*SD*	*t*
Recipient of Payday or Car Title Loan	Yes	25	20.28	4.93	2.25 ($p < .05$)
	No	233	22.83	5.42	

These initial results suggest that not only are PCTL borrowers not more risk tolerant than others, but rather their willingness to engage in financial behavior that entails the risk of loss is actually lower than non-PCTL borrowers. A binary logistic regression was used to further evaluate this finding. Specifically, a backwards entry procedure, using the likelihood ratio, was used with each independent variable and financial risk tolerance entered in to the model. The dependent variable was PCTL borrower or otherwise. The backwards elimination procedure was chosen as a way to eliminate suppressor effects related to known variables associated with PCTL use. Results from the test are shown in Table 3.

Three of the variables were found to be associated with PCTL usage: (a) financial risk tolerance, (b) education, and (c) age. The model was statistically significant, $\chi^2 = 14.21$ (n = 231), $p < .01$, Nagelkerke $R^2 = .13$. The three variable model was able to predict group membership with a 91% overall accuracy level. The logistic regression results indicate that as financial risk tolerance, education, and age increase, holding other factors constant, the likelihood of using a PCTL falls.

Table 3 Logistic Regression Results Showing Association Between PCTL Borrowing and Financial Risk Tolerance

Variable	*B*	*Std. Error*	*Wald*	*Exp(B)*
Financial Risk Tolerance	-0.10*	0.05	3.56	0.91
Education	-0.15**	0.06	6.44	0.86
Age	-0.03*	0.02	3.70	0.97
Constant	3.09*	1.53	4.09	21.98

Notes: $^{**}p < .01$ $^{*}p < .05$

Table 4 provides a possible explanation for the findings showing a negative relationship between financial risk tolerance and the use of PCTL products. While many consumer activists, policy makers, and researchers may associate high interest charges as a potential risky outcome associated with PCTL products, those who use PCTLs do not appear to view this as a risk, or they evaluate the benefit of receiving cash quickly as outweighing the high interest risk. The chi-square findings (Table 4) show that PCTL users value the speed of loan transactions as an important factor when choosing any lender. Sixty-four percent of PCTL borrowers, compared to 43% of non-PCTL borrowers, reported that accessing cash fast was their primary decision factor when choosing a lender. In other words, the traditional marketplace for loans may be perceived as more risky, in terms of accessibility and speed among PCTL borrowers.

This conclusion is supported by other research findings (Caskey, 2001). In addition to speed, PCTL borrowers indicated convenience (60%), need for money quickly (48%), ease of transactions (46%), need for emergency money (44%), nowhere else to get a small loan (28%), no other option being available (28%), needing a small amount of money (24%), and having the lender provide excellent customer service (21%) as being reasons they chose a PCTL.

Table 4 Fast Cash as Reason Why Loan was Taken (*N*)

		Recipient of Payday or Car Title Loan	
		Loan Yes	Loan No
Reason For Payday Loan	Cash Fast YES	16	70
	Cash Fast NO	9	163
$\chi^2(1, N = 258) = 11.72$, $p < .001$			

It may also be that PCTL borrowers simply do not have the financial wherewithal to qualify for a traditional loan, and as such, they turn to alternative lenders. Support for this hypothesis can be found in this study in two ways. First, it was noted that PCTL recipients paid nearly 56% of their monthly income towards housing, whereas non-PCTL borrowers paid 29% of income for housing ($t_{1, 240} = -2.64$, $p = .01$). This type of liquidity strain may force people to constantly search for short-term funding solutions to financial emergencies and contingencies.

A second indication of liquidity constraints facing PCTL borrowers can be seen in Table 5. This table lists financial events and stressors where a significant difference (using a Mann-Whitney U test) was noted between PCTL borrowers and others. Each of these events and stressors was more likely to occur over any given one year period for PCTL borrowers.

A final analysis was completed to determine PCTL borrowers' perceptions of the PCTL process. Those who reported having taken out a PCTL were asked a series of questions using the following six-step scale to evaluate responses: (a) Strongly Disagree (1), (b) Disagree (2), (c) Not Sure, Probably Disagree (3), (d) Not Sure, Probably Agree (4), (e) Agree (5), and (e) Strongly Agree (6). First, respondents were asked if they thought someone who takes out a PCTL is acting responsibly. The median response to this question was 4.0. When asked if PCTL borrowers are careless and irresponsible, respondents answered with a median score of 3.0. Respondents were then asked if those who use PCTL services are helpless consumers. The majority of respondents chose "not sure, probably disagree" (Median = 3.0) as their answer. Finally, each PCTL borrower was asked how satisfied they were with the services provided by the last PCTL provider they worked with. The median response was 5.0, suggesting agreement that they were satisfied with the lender's services.

Table 5 Financial Stressors Faced by PCTL Borrowers

Financial Stressor	*Mean Rank for PCTL Borrowers*	*Mean Rank for Non-PCTL Borrowers*
Delayed expensive purchase until cash available	162.44	125.97
Applied for assistance program	150.54	127.24
Asked for extension on payments	175.98	124.51
Asked friend or family member to lend money	175.82	124.53

Turned down for a loan	176.82	124.42
Obtained credit card advance	163.70	125.83
Bounced a check	162.18	125.99
Exceeded credit limit on credit card	170.08	125.15
Stopped payment on a check	147.34	127.59
Not given as much credit as applied for	173.30	124.80
Wanted to apply for credit, but did not due to fear of rejection	171.64	124.98
Talked with a credit counselor about finances	155.2	126.71
Received call from lender demanding money	169.46	125.21
Had credit card bill that could not be paid	175.90	124.52
Fell behind on rent	157.32	126.52
Fell behind on utilities	169.46	125.21
Had a garage sale to raise money	167.70	125.40
Obtained property from a rent-to-own firm	157.98	126.44
Paid a late fee	182.44	123.82
Paid a utility bill late	177.06	124.40
Received past due bill letter or call	198.18	122.13
Paid credit card bill late	162.30	125.98
Received call from a collection agency	186.40	123.39
Did not have money for an emergency	186.76	123.36
Maxed out a credit card	179.90	124.09
Took cash advance on a credit card	154.86	126.78

5. Discussion

Consider a product or service that guarantees the following attributes: (a) high consumer cost, (b) possibility of perpetual repeat consumer use, (c) expensive consumer penalties for default, and (d) limited regulation. Taken out of context, this might be used to describe the illicit drug business, the gambling industry, or certain types of consumer monopolies. The common thread among firms operating in industries that offer these guarantees is that nearly all have serious negative consequences for consumers who get trapped in ongoing transactions (Karger, 2004). Basically, these industry attributes encompass the working environment of PCTL providers. One might assume that a consumer who enters this marketplace has a high level of financial risk tolerance (i.e., they are willing to incur potential financial losses in order to maximize their immediate financial gain). This paper was written to describe the role financial risk tolerance plays in shaping the decision to borrow from a PCTL provider. Counter to the working assumption among many industry observers, a negative relationship between financial risk tolerance and PCTL use was noted. The risk tolerance of PCTL borrowers was found to be lower, on average, than non-PCTL users.

While this finding runs counter to what many might assume to be true, results match what is implicitly known about PCTL borrowers. These individuals appear to be making the loan choice based less on cognitive appraisal (i.e., information search) and more on convenience. The riskiness of the loans, while understood by consumers, is discounted in favor of factors

that appear to decrease the time, effort, and social stigma associated with facing a financial emergency. In effect, PCTL borrowers seem to be making a trade-off between paying high expenses and subjecting themselves to onerous lending terms in exchange for reduced psychic borrowing costs (Skiba & Tobacman, 2008).

Reported satisfaction levels associated with PCTL products and services was also noteworthy. Either due to cognitive dissonance or genuine contentment, the majority of PCTL borrowers felt that the use of a PCTL product was a responsible way to deal with a short-term liquidity constraint. Overall, borrowers were satisfied with the loan process and the costs associated with these products. Rather than being seen as victims of predatory lenders or unsophisticated consumers easily duped into paying high interest charges, the largest part of PCTL borrowers felt that the products provided a fast, easy, and non-judgmental way to gain access to cash.

5.1 Implications

An apparent dilemma exists in the context of PCTL products. Consumer activists, researchers, and some policy makers find these types of loans to be, at best, a consumer rip-off, and at the worse, a near criminal form of predatory lending. PCTL borrowers, on the other hand, view these loans as a convenient, efficient, and safe form of borrowing to cover short-term liquidity needs. This helps explain why the risk-tolerance profile of PCTL borrowers is actually lower than non-borrowers. That is, these consumers do not view borrowing using high-cost loans as a form of leverage or risk taking.

This does not mean, however, that when viewed objectively PCTL borrower perceptions are accurate. When considered clinically, nearly all researchers and consumer activists would agree with the Iowa Citizens for Community Improvement (2010) organization who noted that PCTL products are not only predatory in nature, but also deceptive and abusive. It behooves those who are interested in advancing the consumer interest to generate positive alternatives for those in need of short-term loans. If alternatives either do not exist or are deemed unacceptable by borrowers, then, by default, policy makers, through lack of action in the marketplace, will direct some borrowers into products than are misleading.

Connor and Skomarovsky (2011) outlined several reasonable recommendations to help stem the growth and continued use of PCTL products and services. Their first recommendation involved encouraging the traditional lending industry to better serve small transaction short-term borrowers. The banking and credit union industries have tended to eschew this market because of the perceived riskiness of the borrowers; however, this perception may be, as highlighted in this paper, a misconception. Stegman (2007) showed how banks that provide short-term loans can generate a 6.98% return on retained earnings.

It is important to remember that PCTL borrowers tend to be responsible, or at a minimum, they have the desire to pay their expenses and meet their financial obligations. They also know that these sources of funds are expensive (Lawrence & Elliehausen, 2007). If PCTL consumers were not, in a sense, financially responsible they would simply walk away from paying bills, hide assets, and turn to illegal sources of funding. Rather, PCTL borrowers often feel that they have “no choice” but to entangle themselves with PCTL providers. One reason

is PCTL borrowers perceive banks and credit unions as being unfriendly, unresponsive, and generally dismissive of a short-term borrower's needs.

Connor and Skomarovsky (2011) also noted that the Consumer Financial Protection Bureau can play an important role in regulating PCTL providers, while also disseminating information to consumers about how unsafe and fundamentally unsound PCTL borrowing can be for consumers. One possible public policy solution involves restricting the use of backdated checks as a form of collateral and/or limiting the number of times a consumer can rollover each outstanding loan. Some have even argued that introducing usury laws (i.e., capping effective interest rates at, say, 36% annually) could work to direct borrowers from PCTL providers to banks and credit unions.

In summary, the results from this study add to the existing literature in several ways. First, it was shown that PCTL borrowers have a lower risk-tolerance profile than non-borrowers. Second, PCTL borrowers tend to be liquidity constrained. Third, nearly all PCTL borrowers are disposed to act responsibly in searching for other loans prior to using a PCTL service, and fourth, among those that use PCTL products, the majority are satisfied with their choice.

While these findings are noteworthy, it is important to judge the results in the context of the sample frame. Future studies should attempt to use a more nationally diverse and larger sample. This will allow for additional parametric statistics to be used in a multivariate manner. Being sure to include risk-tolerance measures in further studies will help validate the exploratory risk-profile findings. For example, further research may find that financial risk tolerance differs from borrowing risk tolerance. In the current study, financial risk tolerance was assessed using a combination of items, several of which were investment oriented. A question to be answered is whether consumers view lending risk differently than financial risk. Additionally, it would be helpful, with a larger sample, to differentiate between the unsecured nature of payday loans from the secured aspect of title loans. It is possible that the demographic, socioeconomic, and risk profile of those who use these loans is different. Finally, a comprehensive meta-analysis of the existing PCTL literature would be useful as a way to better describe the needs, constraints, resources, and attitudes of PCTL borrowers as policy makers conceptualize new products to introduce into the marketplace.

References

[1] S. Agarwal, P.M. Skiba and J. Tobacman, Payday loans and credit cards: New liquidity and credit scoring puzzles, *NBER Working Paper No. 14659*, (2009), http://www.nber.org/papers/w14659.

[2] B. Avery, Payday loans versus pawnshops: The effects of loan fee limits on household use, *2011 Federal Reserve System Research Conference*, (2011), http://www.frbsf.org/community/conferences/2011ResearchConference/docs/2-avery-paper.pdf.

[3] J.P. Caskey, Payday lending, *Journal of Financial Counseling and Planning*, 12(2) (2001), 1-14.

[4] Phantom demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume, Center for Responsible Lending, (2009),

http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-date-generates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html

[5] K. Connor and M. Skomarovsky, The predators' creditors: How the biggest banks are bankrolling the payday loan industry, (2011), http://showdowninamerica.org/files/payday-final-091410.pdf

[6] L. Ding, R.G. Quercia, W. Li and J. Ratcliffe, Risky borrowers or risky mortgages: Disaggregating effects using propensity score models, *Journal of Real Estate Research*, 33(2011), 245-277.

[7] G. Elliehausen and E.C. Lawrence, *Payday Advance Credit in America: An Analysis of Customer Demand*, (2001), Credit Research Center, Washington, DC: Georgetown University.

[8] FDIC national survey of unbanked and underbanked household: Executive summary, *Federal Deposit Insurance Corporation*, (2009), http://www.fdic.gov/householdsurvey/Executive_Summary.pdf.

[9] M. Finke, S. Huston, E. Siman and M. Corlija, Characteristics of recent adjustable-rate mortgage borrowers, *Journal of Financial Counseling and Planning*, 16(2) (2005), 17-28.

[10] A. Gallmeyer and W.T. Roberts, Payday lenders and economically distressed communities: A spatial analysis of financial predation, *The Social Science Journal*, 46(2009), 521-538.

[11] J.A. Fox, *Testimony of Jean Ann Fox before the Subcommittee on Financial Institutions and Consumer Credit Regarding H.R. 1214, the Payday Loan Reform Act of 2009, 04/02/09 (2009)*, http://www.consumerfed.org/financial-services/credit-and-debt/payday-loanscar-titleother#test

[12] D.D. Godwin, Predictors of household's debt repayment difficulties, *Journal of Financial Counseling and Planning*, 10(1) (1999), 67-78.

[13] J.E. Grable and S. Joo, A further examination of financial help-seeking behavior, *Journal of Financial Counseling and Planning*, 12(1) (2001), 55-66.

[14] J. Hirschleifer, On the theory of optimal investment decision, *Journal of Political Economy*, 66(1958), 329-52.

[15] J.M. Hogarth and M.A. Hilgert, A profile of consumers with high-interest loans, *Journal of Financial Counseling and Planning*, 13(1) (2002), 15-37.

[16] Iowa Citizens for Community Action, CCI report shows Wells Fargo is top financier of payday lenders [Press Release] (2010), http://www,iowaacci.org/news/pressreleases.

[17] F.T. Juster and R.P. Shay, Consumer sensitivity to finance rates: An empirical and analytical investigation, *NBER Occasional Paper No. 88* (1964), http://www.nber.org/books/just64-2.

[18] H.J. Karger, Scamming the poor: The modern fringe economy, *The Social Policy Journal*, 3(2004), 39-54.

[19] G. Katona, *Psychological Economics*, (1975), New York: Elsevier.

[20] E.C. Lawrence and G. Elliehausen, A comparative analysis of payday loan customers, *Contemporary Economic Policy*, 26 (2007), 299-316.

[21] K. Lydersen, Payday profiteers, *Multinational Monitor*, 22 (2001), 9-15.

[22] R. O'Brien, We don't do banks: Financial lives of families on public assistance (2012), http://assets.newamerica.net/sites/newamerica.net/files/policydocs/Rourke March2012.pdf.

[23] P.M. Skiba and J. Tobacman, Payday loans, uncertainty and discounting: Explaining patterns of borrowing, repayment and default, *Vanderbilt University Law School Working Paper No. 80-33*, (2008), http://ssrn.com/abstract_id=1319751.

[24] H. Smith, M.S. Finke and S.J. Huston, The impact of financial sophistication on adjustable rate mortgage ownership, *Journal of Financial Counseling and Planning*, 22(2) (2011), 3-15.

[25] M.A. Stegman, Payday lending, *The Journal of Economic Perspectives*, 21(2007), 169-190.

[26] M.A. Stegman and R. Faris, Payday lending: A business model that encourages chronic borrowing, *Economic Development Quarterly*, 17(2003), 8-32.

[27] P. Storms, Guiding your client through the mortgage maze, *Journal of Financial Planning*, 5(2) (1992), 87-92.

[28] T. Zywicki, Money to go, *Regulation*, 33(2) (2010), 32-37.