

A COMPARATIVE ANALYSIS OF PAYDAY LOAN CUSTOMERS

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One of the most rapidly growing and controversial forms of consumer lending to recently emerge in the marketplace has been payday advances. This form of credit allows the borrower to obtain a small amount of cash for a short period of time. Claims of predatory lending often arise due to the high annual percentage rates that result from the fees for borrowing small amounts of money for 2 wk or less. By analyzing the data collected in a national survey of payday customers, this research allows policy-makers to better understand what type of consumer borrows from payday lenders, for what purpose, and what the true benefits and costs are. The results confirm a strong demand for payday loans that satisfy a real financial need within a certain segment of the population. (JEL D12, D18, G20)

I. INTRODUCTION

In recent years, one of the most controversial segments of the consumer finance industry has been payday loans. In the popular press, critics often complain that this form of credit is predatory in nature since it charges many low-income households triple-digit annual percentage rates (APRs) to borrow small sums of money for a short period of time. Lenders, on the other hand, note that returned check charges and late fees can result in even higher charges for consumers. Payday companies also defend their practices by pointing to the growing demand for these services, suggesting that this market would otherwise be underserved. The industry argues that the typical customers are not the low-income persons who are being forced by circumstances beyond their control to borrow increasing amounts of money until they are financially distressed. Unfortunately, despite the strong opinions held by both sides, there has been very little academic research conducted on the industry

to allow policymakers to understand what type of consumer borrows from payday lenders, for what purpose, and what the true benefits and costs are.¹ The goal of this article is partially to fill this void by investigating the economic issues surrounding payday lending and carefully comparing the characteristics of consumers who choose to borrow money in this form rather than from alternative sources of short-term financing.

The payday loan industry has experienced phenomenal growth over the past decade and a half. As recently as 1990, there were almost no payday loan facilities in the United States. By 2006, the Community Financial Services Association of America (CFSA), the trade association for the payday industry, reported that there were more than 15,000 loan offices, with \$25 billion in short-term credit extended. This growth demonstrates a strong consumer demand for small amounts of short-term credit that may not be adequately served by more traditional sources of consumer lending. Historically, finance companies offered small closed-end instalment loans, but these lenders

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1. At first glance, it would seem irrational for any consumer to borrow money at an interest rate exceeding 400% under any circumstance. However, Elliehausen and Lawrence (2001) and Elliehausen (2006) have demonstrated that there are plausible situations in which the use of high-price credit is wealth maximizing and rational.

ABBREVIATIONS

APR: Annual Percentage Rates
CFSA: Community Financial Services
Association of America

have largely withdrawn from this market because of the high production cost (Brito and Hartley, 1995).² Bank cards are a source for borrowing small amounts, but despite the spread of bank credit cards to higher risk consumers, many payday customers either do not have bank credit cards or have already reached the maximum credit limit. Economic theory, as discussed below, suggests that consumers with limited access to credit may significantly benefit from the relaxation of constraints.³ Several other sources are available for borrowing small amounts, but payday loans are emerging as one of the most heavily used of these sources.⁴

In the United States, the payday industry is very diverse. There are four large publicly traded companies that have expanded rapidly and offer payday advances and other services like check cashing and pawnshops. The two largest, Cash America and Advance America, each had approximately \$670 million in revenue in 2006, more than 4,500 employees and market capitalizations in excess of \$1.2 billion. EZCorp and First Cash Financial Services are approximately half the size of the two leaders but are solid competitors. The other major player, Ace Cash Express, went from a publicly traded company to a privately held one in 2006. The rest of the industry consists of smaller independent local and regional firms, most of which are family owned and operated with limited capital resources. Some payday companies partner with national banks in states like South Dakota and Delaware that do not have interest rate ceilings. This allows the payday companies to export the more

favorable rates to other states under the National Banking Act. Other banks (e.g., Wells Fargo) do their own direct payday lending. In an interesting parallel to online gambling, online payday loans are also available to Americans with some companies originating offshore in places like Costa Rica (Eyre, 2005).

Payday loans are available in some foreign countries including the United Kingdom, Canada, Sweden, and Australia. It should also be noted that payroll lending has long been popular in emerging markets. For example, in India, South Africa, and other countries with weak collateral laws and poor credit history files, payrolls are often the only available collateral. The United States currently provides researchers with a unique opportunity to study the efficacy of these services in a large, developed market and assess the various needs the product satisfies for consumers.

Payday lenders consist of monoline companies that offer only payday advances or multiproduct companies that offer other services such as check cashing, pawn loans, and wire transfer. Payday credit is different from other small loans offered by finance companies. Payday advances are single payment loans rather than installment loans, and the underwriting process for payday loans does not involve a credit investigation. Therefore, the costs and risks of the two types of credit are not the same. Yet, it is likely that the factors influencing the demand for these and other higher price products are similar. This article investigates the demand for payday credit using recent data from a representative survey of customers of payday companies belonging to the industry's national trade association, the CFSA. That payday loans satisfy a strong demand for small, short-term consumer loans is evident from the explosive growth of the payday advance industry.

II. THE PAYDAY ADVANCE TRANSACTION

A payday advance is a small, short-term, single payment consumer loan. In a typical transaction, the customer writes a personal check for the sum of the loan amount plus a finance charge. In most cases, the borrower will not have a sufficient balance in his checking account at the time the check is written to clear the check. However, as part of the contract, the lender agrees in writing to defer

2. The traditional small loan from a consumer finance company was generally larger than typical payday loan sizes, in part, because rate ceilings were not sufficiently high for very small loan sizes to be profitable (National Commission on Consumer Finance, 1972). An exception that does permit loans in the size range of payday loans is Article 3.16 of the Texas Consumer Finance Code, which has special interest rate ceilings for borrowing \$440 or less (Elliehausen, 2006).

3. Even a small amount of cash may be sufficient to cover an unexpected emergency like getting a prescription filled for an illness, getting a car repaired so the person can get to work, paying a critical utility bill, etc. The consequences of not borrowing may be so severe that even a \$60 cost for a \$300 payday loan may seem trivial in comparison to losing a job or having one's electric shutoff.

4. Other sources for small amounts of credit include pawnshops, title loan companies, sale/leaseback contracts, check overdraft protection, loan sharks, and friends and relatives. For more information on these alternatives, see Caskey (1991), Johnson and Johnson (1998), Morstad (2001), and Quester and Fox (2005).

depositing the postdated check until the customer gets paid, typically 7–30 d later. On the next payday, the customer may redeem the check by paying the loan balance with cash or the creditor may deposit the check. In some states, the customer may extend the payday advance by paying only the finance charge and writing a new check. Other names for this product are payday loans, cash advances, and deferred presentment services.

Payday lenders operate under special state laws specifically authorizing payday advances or as middlemen for federally chartered financial institutions located in states that permit such lending. Thirty-seven states have passed laws regulating payday advances, many of which also incorporate Best Practices to set industry standards.⁵ The size of the loan usually ranges from \$100 to \$500, although a few jurisdictions (e.g., the District of Columbia) permit payday advances up to \$1,000. Finance charges are typically between \$15 and \$20 per \$100 of the loan amount. The industry practice is to assess the same dollar amount for the finance charge regardless of whether the money is borrowed for 4 or 14 d. As a result, the APRs can range from 390% to more than 1,000% for money borrowed for only a few days. Not surprisingly, these rates have fueled much of the controversy in the press over the merits of payday loans.

III. THE INDUSTRY COST STRUCTURE

As shown by Benston (1975) and Durkin and Elliehausen (1998), the cost structure of the consumer finance industry is such that operating costs increase less than proportionately with loan size. This relationship exists because many of the costs occur whenever an application is accepted, a loan is made, or payments are serviced. These activities must be performed regardless of the size of the loan. Companies producing larger loans have lower costs per dollar of credit extended than those producing smaller loans. Thus, for a given interest rate, larger loans are more profitable than smaller loans. Because of the increased competition unleashed by the deregulation

of financial service markets in the 1980s, many finance companies (which historically served the small-loan market) shifted their business toward more profitable, large consumer loans. Banks offer revolving credit (bank cards and check credit) to satisfy small and short-term credit needs, but some consumers still have limited access to such credit, despite the development of a subprime market for bank cards.

To lower the overhead cost of providing credit, payday companies have streamlined the application procedure and underwriting process. The underwriting process consists primarily of verifying the applicant's income and the existence of a bank account. Lenders typically request that applicants bring their last bank statement, most recent pay stub, identification, and proof of residence. Creditors also limit the maximum amount of the advance to a specified percentage of the customer's take-home pay. Unlike traditional lenders, payday advance companies do not obtain a credit bureau report or perform any credit analysis using the consumer's expense information. Some companies, however, do subscribe to a risk assessment service, called Tele-Track, which provides information on the current payday advance use by the applicant.

Taking a postdated check reduces the cost of collection. If the consumer fails to redeem the check, the payday company has a relatively low-cost method of collection. The company can deposit the check to obtain payment of the loan amount and finance charge. Depositing the check does not ensure payment, of course, since the customer may not have sufficient funds in his account. But not having adequate balances in the account subjects the customer to bank overdraft fees, which makes failure to repay the loan costly to the customer and provides an added incentive. This externally imposed penalty thereby reduces both the probability of default and the expected value of collection costs.

Very little empirical data on the cost structure of the payday industry are available. Flannery and Samolyk (2005) provided the most comprehensive analysis of payday loan costs using office-level data from two monoline companies. Like other consumer lenders, payday lenders' operations are very labor intensive. Salaries and administrative expenses account for nearly half of annual gross revenues of these companies. Payday company

5. The states that do not presently have a payday advance statute or have rate ceilings that prevent payday advances include Texas, Arkansas, Georgia, North Carolina, West Virginia, Maryland, Pennsylvania, New Jersey, New York, Connecticut, Massachusetts, Vermont, and Maine.

employees take applications, disburse funds, receive payments, and collect overdue accounts. Payday lenders' streamlined process produces a relatively risky product. Loan losses amounted to 13.7% of gross revenues across all offices, which is very high compared to losses for other forms of consumer credit.⁶

IV. ANALYTICAL MODEL FOR CONSUMER CREDIT USE

Juster and Shay (1964) developed the basic theoretical model of consumer credit use, which builds on the consumption/investment choice model of Fisher (1930) and Hirschleifer (1958). Consumer credit is typically used to finance the purchase of household durable goods, which provide a return in the form of a stream of services over a period of time. The economic value of the stream of services can often be measured in terms of the cost of purchasing those services in the market. For example, the value of the services of a washing machine could be measured by the cost of obtaining the services in a Laundromat; the services of an automobile could be measured by renting a car or the cost of using public transport; or the services of a television or DVD player can be valued by the cost of going to the cinema, a concert, or other entertainment activities that would be undertaken if television or DVD player were not available. Empirical research by Poapst and Walters (1964) and Dunkelberg and Stephenson (1975) suggests that rates of return on household durables can be quite large when usage is high.

Viewing the purchase of a durable as an investment, the consumer compares the purchase price of the durable with the present value of the services it provides. At the optimum point, the rate of return on investment is equated with the appropriate discount rate. This discount rate can be the borrowing rate, the rate of time preference, or the lending rate. The extension of the consumption/investment model by Juster and Shay allows for borrowing limits (rationing) for a given interest rate, with the possibility of additional (also limited)

credit at a higher rate. The model shows the conditions under which borrowing at high rates may be optimal for a consumer. These conditions are characterized by relatively high-return investment opportunities, low current income, and strong preferences for current consumption.

Juster and Shay used this framework to analyze consumer credit markets. Normally, consumer credit is repaid by instalments out of future income. Most consumers do not have sufficient liquid assets to repay debts with a lump sum. To reduce default risk, creditors typically limit the amount of credit, requiring borrowers to build equity in the durable being financed. The equity requirement reduces default risk by making nonpayment more costly to the borrower. This requirement may also affect the cost of financing the durable because building equity forces the borrower to forgo current consumption. Borrowers not wishing to forgo current consumption to satisfy equity requirements can sometimes obtain additional credit using unsecured personal credit, but this credit is riskier and more expensive. For many marginal consumers, additional unsecured personal credit is available only from specialized high-risk creditors at a substantially higher cost.

A. *Types of Borrowers*

According to the terminology of Juster and Shay, borrowers who were constrained by creditors' equity requirements are referred to as "rationed," whereas others who were not so constrained are "unrationed." They hypothesized that rationed borrowers would be in early family life-cycle stages where rates of return on household investments would be high. These borrowers would also have relatively low or moderate income, which would make sacrifices in current consumption to satisfy equity requirements very costly. Rationed borrowers would have relatively low levels of savings, making use of liquid assets to pay for household investment more costly to them. Rationed borrowers' demand for credit would be unresponsive to increases in interest rates because returns on household investment are high and the availability of credit is more limited.

Unrationed borrowers, in contrast, generally would be in later family life-cycle stages or have relatively high incomes. Given their

6. In the consumer finance company data used by Durkin and Elliehausen (1998), loan losses were 8.6% of revenue. For consumer finance companies producing very small instalment loans (about the same size as payday loans) under Article 3.16 of the Texas Consumer Credit Code, loan losses in 1968 were 8.7% of revenue (Durkin, 1975).

current asset holdings, these borrowers have relatively few high-return household investment opportunities and would have discretionary income to pay for new household durables. Their older age and higher income allow unrationed borrowers to have proportionately higher levels of savings. Thus, using liquid assets to purchase durables would not be especially difficult for unrationed consumers. The model predicts that unrationed borrowers' demand for credit would be sensitive to APRs.

There is no question consumer credit markets have changed substantially since the study by Juster and Shay. Advances in information and technology have improved creditors' abilities to assess and price risk. Equity requirements have been relaxed, as terms to maturity have lengthened for most closed-end instalment credit. Another consequence of these developments is the growth in availability of unsecured credit through bank credit cards. Today, many borrowers use bank cards in much the same way as Juster and Shay described earlier borrowers using unsecured personal loans (Bizer and DeMarzo, 1992; Brito and Hartley, 1995). A subprime credit card market has developed specifically to serve such borrowers, although some consumers do not have bank credit cards and market innovations have flourished to provide credit to rationed borrowers.⁷ The emergence of the modern payday advance industry is one such development.

Recent research by Attanasio (1994) and Attanasio, Goldberg, and Kyriazidou (2000) supports the continued applicability of the model by Juster and Shay. These papers test hypotheses suggested by Juster and Shay using recent data on automobile purchases from the Consumer Expenditure Survey. Findings were consistent with the hypotheses of Juster and Shay. Middle-age consumers' demand for credit was more sensitive to changes in interest rates than younger consumers' demand. Younger consumers' demand was more sensitive to changes in the term to maturity, which has a relatively larger effect than interest rates

on the size of monthly payments, than middle-age consumers.

V. EVALUATING AVAILABILITY OF ALTERNATIVE FINANCING

Economists studying use of credit products should evaluate the transaction by comparing the investment outlay with the present value of savings and using the cost of the source for the discount rate in a present value calculation.⁸ However, a few characteristics of consumers' financial behavior may cause the nominal and subjective costs of alternatives to diverge. These characteristics involve the precautionary motive for saving and the use of financial contracts to enforce budgetary discipline. Both characteristics are described generally in the literature on behavioral economics (Rabin, 1998).

First, subjective yields on liquid asset holdings tend to be high because precautionary motives for saving are strong. Many consumers draw down liquid assets grudgingly even when events occur that impair their earnings potential or require large expenditures. Katona (1975) has shown their reluctance to use liquid assets stems from a belief that the worse the current situation, the greater is the need to maintain reserves for future emergencies. As a consequence, subjective yields on liquid assets are often substantially greater than nominal yields. This attribute of financial behavior may explain consumers' simultaneous holding of debt and relatively large amounts of liquid assets. The weighted average interest rate on the outstanding consumer credit is greater than the nominal yield but less than the subjective yield on the liquid assets. Since consumers who have personal loans from finance companies or credit card debt also hold liquid assets, the subjective yield on liquid assets is likely to be quite high for some consumers.

Second, consumers may use consumer credit rather than draw against their liquid assets because they may not have the discipline to replenish the depleted assets. The loan agreement forces the borrower to budget his money, saving via debt repayment rather than spend future income on the numerous goods

7. Durkin (2000) reported that 32% of families did not have a bank credit card and 27% of families did not have any credit cards in 2000. Lack of a bank card was especially common in the lowest quartile of income (72% of families in the lowest quartile did not have a bank card), but some families in higher quartiles also did not have bank cards.

8. For short-term loans, consumers can evaluate cash flows without discounting because the effect of discounting is often only a few cents for relatively small amounts over 1 or 2 wk. For examples, see Elliehausen (2006, table 3.2).

and services available in the market. This practice is expensive, but considerable evidence indicates that many consumers are willing to pay a premium to be protected against their own bad habits (Juster and Shay, 1964; Katona, 1975). Consumers have also used other types of contractual arrangements—for example, whole life insurance, lay-away plans, and Christmas club accounts—to force themselves to budget their money better. It is likely that some consumers use payday credit to perform a similar mandatory budgeting service.

Third, considerations that make consumers reluctant to use liquid assets may similarly influence their utilization of credit cards. Unused credit limits on credit cards are an asset against which some consumers may be hesitant to borrow. Recent evidence by Gross and Souleles (2000) and Bird and Hagstrom (2001) suggests that consumers maintain target levels of unused credit limits. One interpretation for this behavior is that consumers hold some precautionary assets in the form of unused credit limits. The subjective cost of borrowing beyond the target levels would be greater than the nominal interest rate. In addition, these consumers according to Katona (1975) may be reluctant to increase credit card debt because they fear that they will not have the discipline to make payments on the additional debt. Using payday loans as a contractual obligation to enforce budgetary discipline may be expensive, but perhaps less so than the exposure of increased vulnerability to higher debt levels over the long run.

VI. THE SURVEY

Contrary to the impression given by the popular media, the use of payday loans among the general population is quite uncommon. In September 2005, responses to an omnibus survey conducted by International Communications Research indicated that just 2% of all U.S. adults used a payday loan during the previous 12 mo.⁹ This is a small percentage of the lower to moderate income consumers in early life-cycle stages who have high demand for credit or the credit constrained customers who may have experienced recent loan turn-down or believed that they might be turned

9. International Communications Research's omnibus survey, called EXCEL, is a national twice-weekly telephone survey of about 1,000 adults, which is representative of the adult population of the United States.

down. Many more high credit demand, credit constrained consumers do not use payday loans than use payday loans.

Knowledge of consumers' use of payday credit has been limited mainly to anecdotal evidence and individual companies' marketing studies. Broadly representative data have been largely unavailable. The motivation behind the current research was to assess whether payday loan customers are the types of consumers that economic theory suggests are likely to benefit from use of high-price credit and whether their decisions are informed and with purpose.

This article draws on a national consumer survey, collecting data from a representative sample of customers of companies belonging to the industry trade association, the CFSA. The association has more than 60 member companies operating approximately 8,000 offices, which is just over half of the 15,000 estimated offices providing similar short-term loans nationwide. While not necessarily representative of customers of all companies, use of the list of customers of CFSA member companies was a cost-effective method of identifying members of a relatively rare population.¹⁰ The survey was a telephone interview of 427 payday customers and was conducted between December 28, 2000, and January 9, 2001.¹¹

VII. THE RESULTS

A. Are Payday Loan Customers Likely to Benefit from High-Price Credit?

Payday customers' economic situations are more clearly seen when measured against benchmarks that define different market segments. We consider three groups of high-price credit users: finance company customers, bank card holders who revolve balances, and customers of pawnshops.¹² Finance companies have historically provided small consumer

10. It is possible, however, that customers of CFSA member companies may have different experiences than those of nonmember companies. For example, because the Association's "Best Practices" may set higher standards of conduct for members, customers of member companies may have fewer problems and express greater satisfaction than those of nonmember companies.

11. For more details on survey methodology, sampling design, questions asked, response rates, etc., see Elliehausen and Lawrence (2001).

12. Bank card revolvers are customers who make only monthly payments on their credit cards and thus carry a balance. In contrast, nonrevolvers pay the entire balance each month within the payment period and do not incur any finance charges.

loans to lower and moderate income borrowers who are relatively risky and often have difficulty obtaining credit from banks. Bank credit cards are of interest because bank cards can be viewed as the established, mainstream credit product that allows borrowing of relatively small amounts of money quickly and conveniently. Pawnshops have historically been a source of small amounts of credit for marginal borrowers.

Income distributions distinguish customers of different types of lenders, consistent with our description above. Finance companies disproportionately serve moderate and lower income consumers (Table 1). Bank card holders who revolve balances are disproportionately higher and moderate income consumers. Pawnshop borrowers are very disproportionately lower income consumers.

Payday companies are distinct in their relatively heavy concentration in customers pre-

dominately having moderate incomes. A little more than half of payday customers have family incomes between \$25,000 and \$49,999. This fraction is considerably larger than the 36.8% for clients of finance companies, the 34.5% of bank card revolvers, 28.1% of pawnshop customers with moderate income, and 29% for the population as a whole. Although many payday customers have lower or higher incomes, these income groups are relatively less important to payday lenders than to other creditors. Payday borrowers are less likely to have incomes under \$25,000 than pawnshop and finance company customers. The requirement that payday customers have a checking account prevents many lower income households from obtaining payday loans since many lower income households do not have checking accounts. Payday customers are significantly less likely than bank card holders who revolve balances to have incomes above

TABLE 1
Summary Characteristics of Customers

Variable	Payday Advance Customers (%)	Finance Companies (%)	Bank Card Revolvers (%)	Pawnshops (%)	All Adults (%)
Income					
Less than \$25,000	23.0	35.5	20.4	64.9	31.5
\$25,000-\$49,999	51.5	36.8	34.5	28.1	29.0
\$50,000 or more	25.4	27.7	45.1	7.1	39.2
Age (yr)					
Less than 35	36.4	38.6	32.8	53.1	23.0
35-44	31.9	35.7	23.6	31.1	24.3
45-54	21.7	13.1	24.0	11.6	19.8
55-64	6.5	7.3	10.6	4.3 ^a	13.1
Older than 65	3.5	5.3	9.0	na	19.2
Marital status					
Never married	16.8	14.7	15.3	32.6	16.3
Married or living with partner	57.9	64.2	62.9	38.2	60.9
Divorced or separated	23.0	35.8	15.2	29.2 ^b	13.8
Widowed	2.4	10.3	6.7	na	9.1
Has children	65.3	73.8	57.1	na	48.4
Education					
No high school diploma	6.2	14.9	3.7	17.1	9.7
High school diploma	38.3	48.1	29.7	38.1	34.3
Some college	36.1	22.5	28.2	35.8	21.1
College degree	19.4	14.6	38.5	9.0	34.9

na, not available.

^aOlder than 65.

^bIncludes widows.

Sources: Bank card and all adults data are from the *Survey of Consumer Attitudes* (January 2000). Pawnshop data are from Johnson and Johnson (1998). Data are for active borrowers. Finance companies data are from *Survey of Consumer Finances* (1998).

\$50,000. As discussed below, many payday customers do not have bank credit cards or have borrowed fully against their credit limits if they have bank credit cards.

Consistent with the predictions of the economic model, customers of these high-price credit sources are disproportionately young. Two-thirds of the payday customers are younger than 45 yr, and 36.4% younger than 35 yr, compared to 47.3% and 23.0% of the population, respectively. Payday customers are younger than bank card revolvers but not as youthful as pawnshop borrowers or customers of finance companies. Just over half of bank card holders are under age 45 and 32.8% are under age 35. Eighty-four percent of pawnshop borrowers are under the age of 45, with 53.1% under age 35; and 74.3% of finance company borrowers are under age 45. Relatively few payday customers are old. One in 10 payday borrowers' age is 55 yr or older, compared to one-third of the population.

When older consumers use high-price credit, they are more likely to use a bank card. Two in 10 of all bank card holders who revolve balances are aged 55 or above. It is noteworthy that the percentage of bank card customers who revolve balances is considerably greater than that for customers of other high-price lenders but much less than the proportion 55 or older in the population. This finding is consistent with hypotheses about consumer credit use. Consumers in early life-cycle stages tend to have a high demand for credit, which may be satisfied by less traditional forms of credit. In general, payday customers are younger than bank card holders, suggesting that payday loans and credit cards may not be substitutes for some customers. Of all the high-price credit customer groups, the age distributions of payday and finance company customers are the most similar.

More than half of payday customers are married or living with a partner, and nearly a quarter are divorced or separated. Sixty-five percent of payday customers have children younger than 18 yr living in the household. The concentration of payday customers in families and in younger age groups indicates that payday customers generally are in life-cycle stages in which demand for credit tends to be high. Finance company customers, and to a lesser extent consumers who revolve bank cards, are also disproportionately married (including living as married) or divorced

(including separated) and have children in the household. Although the greater proportion of pawnshop borrowers are married/living as married or divorced/separated, a third of pawnshop borrowers were never married, a much larger proportion than those of the population or the other customer groups. The disproportionate percentage of never-married consumers among pawnshop borrowers differs from payday, finance company, and bank card borrowers.

Nearly all payday customers borrow money from other sources. As reported in Table 2, fully 91.6% of payday customers also rely on other types of consumer credit. They disproportionately use closed-end consumer credit. Fifty-three percent of payday customers had auto loans compared to 33.5% of the population, and 36.6% had other closed-end consumer loans compared to 21.4% of the population. In contrast, payday customers are less likely than the population overall to use revolving credit. Fifty-seven percent of payday borrowers have bank cards compared to 72.5% of the population, and 21.5% have retail cards compared to 56.8% of the population. Not only are payday customers more likely than the population as a whole to use consumer credit, but they are also more likely to have higher debt service burdens when they use consumer credit. Twenty-seven percent of payday customers have monthly debt payments of 20% or more of income compared to 9.8% of all adults.

Payday customers have relatively low usage of mortgage credit, reflecting their lower rate of home ownership. This finding provides further support for the hypothesis that payday customers' limited resources cause them to be rationed. By far most payday customers who do own homes, like homeowners overall, have mortgages.

Perhaps because of their limited resources and relatively heavy use of credit, payday customers often experienced limitations on additional credit use.¹³ As reported in Table 2, 73% of payday customers reported loan turn-downs or limitations in the previous 5 yr. This percentage is over three times the percentage of turn-downs and limitations for the

13. Relatively high debt burdens likely contributed to financial problems. A quarter of payday customers had late payments of 60 d or more in the past year compared to 5.8% of all adults (numbers not in table). See Elliehausen and Lawrence (2001).

TABLE 2
Use of Selected Types of Credit

Variable	Payday Advance Customers (%)	Finance Companies (%)	Bank Card Revolvers (%)	Pawnshops (%)	All Adults (%)
A. Consumer credit ^a	91.6	100.0	100.0	na	82.4
Open-end consumer credit					
Bank cards	56.5	53.3	100.0	53.4	72.5
Retail cards	21.5	51.8	76.8	37.7	56.8
Closed-end consumer credit					
Auto loans	52.9	55.4	48.5	na	33.5
Other	36.6	76.5	8.2	na	21.4
Memo: consumer debt payments 20% or more of monthly income	27.4	30.8	20.0	na	9.8
B. Mortgage credit					
Home equity line of credit	6.8	4.6	9.3	na	7.9
Other mortgage	32.0	48.0	59.9	na	46.0
Memo: own home	41.7	64.8	73.5	34.8	63.3
C. Credit request turned down or limited in past 5 yr	73.0	na	na	na	21.8

^aIncludes nonrevolving use of bank or retail card.

Sources: Bank card data are from the *Survey of Consumer Attitudes* (January 2000). Pawnshop data are from Johnson and Johnson (1998). Finance company data are from *Survey of Consumer Finances* (1998).

population as a whole and is further evidenced that payday customers are rationed. Thus, most payday customers are in income and family lifecycle groups that tend to have high demand for credit. Their actual credit use is consistent with this expectation. Nearly all payday customers use other forms of credit, and many allocate a relatively large percentage of their monthly income to service the debt. And well over half of payday customers recently experienced limitations to additional credit use. These are precisely the characteristics that may justify use of high-price credit to relax credit market constraints.¹⁴

These credit use characteristics also describe users of other high-price credit products. Finance company and bank card borrowers were also more likely than the population to have consumer debt payments of 20% or more of monthly income (Table 2). Like payday customers, finance company borrowers disproportionately have auto loans and other closed-end consumer loans. Bank card borrowers are more likely than the population as a whole to have auto loans but dis-

proportionately use revolving credit instead of other closed-end credit. Finance company and bank card borrowers may represent more mature segments of the high-price credit market than payday borrowers, as suggested by their home ownership rates. Greater percentages of loan turndowns and limitations of finance company and bank card borrowers than the population supports the hypothesis that finance company and bank card borrowers too are often rationed.

B. Are Payday Loan Customers' Decisions Purposive and Informed?

Cognitive models describe the decision process as a series of stages in which consumers recognize a need, gather information, evaluate alternatives, make a decision, and evaluate the decision (Engel, Blackwell, and Miniard, 1997; Katona, 1975). The process is influenced by product characteristics, consumer characteristics, and situational factors. Research has identified influences that tend to extend decision processes or lead consumers to omit steps.

Product Characteristics. Research on consumers' decisions indicates that the products that are high priced relative to income or

14. In a preliminary study, Hanson and Morgan (2005) found evidence that payday lending loosened credit constraints without increasing credit delinquencies, results that support the theoretical prediction that high-price credit may be wealth increasing.

commit the consumers for an extended period of time tend to be associated with extended decision processes. Although the cost of payday loans is large relative to the size of the loan, the cost of payday loans is small relative to most customers' monthly budgets. And the typical term of 10–14 d until the next payday is relatively short. These two characteristics of the product suggest that the decision process for payday loans may not be particularly extensive.

Consumer Characteristics. Consumers with higher levels of education are more likely to have extended decision processes than those with lower levels of education. This observation may be attributed to greater cognitive ability and efficiency in search. For consumer credit, higher levels of education are associated with greater awareness of APRs and finance charges (Durkin and Elliehausen, 1978; Shay and Brandt, 1979). Awareness does not necessarily mean that consumers use the information, but a lack of awareness suggests that the information was not very important in the decision process. Payday customers are concentrated in the middle levels of educational achievement. As shown in Table 1, 38.3% of payday consumers have high school diplomas and 36.1% have some college. Evidence indicates that the majority of consumers in these education groups are aware of APRs for the different types of credit they use.

The survey questioned payday customers about the cost of their most recent new payday loan. Nearly all customers reported a finance charge. Ninety-one percent of customers reported a finance charge that was within the range of market rates for payday loans, which suggests that these customers were reasonably aware of the finance charge (numbers not in table).¹⁵ In contrast, payday customers were not aware of the APR for their most recent payday loan. Seventy-eight percent of customers recalled receiving information on the APR, which customers received in Truth in Lending disclosures. Only one in five of these customers could recall the rate, however. And more than half reported rates that were too low to be consistent with the range of market rates. Clearly, these responses show that payday customers considered the finance

charge, not the APR, as the cost of the loan. It is notable that the payday customers' awareness of finance charges for such credit is among the highest levels of awareness of cost for any credit product.

Despite the low dollar amount of the finance charge, payday customers do not perceive the cost of payday loans as less expensive than some of the costs they may be trying to avoid. Nearly half of payday customers said that payday loans were more expensive than returned check fees (Table 3). Similarly, 40.8% of customers said that payday loans were more expensive than late fees for mortgage or rent, and 33.5% said that payday loans were more expensive than late fees on credit cards or other consumer debts. These percentages ranged from nearly two times higher for returned check fees to a little more than a third higher for late payments for credit card and other consumer debt than the percentages saying that payday loans were less expensive.¹⁶

That consumers might turn to payday loans to avoid the stigma of returned checks or late fees despite payday loans' perceived high cost is understandable. Electronic databases like ChexSystems make payment using checks difficult for those with a history of bouncing checks (Beckett, 2000), and late payments on debts make future borrowing from mainstream lenders expensive or possibly even unavailable.

In sum, nearly all payday customers recalled the finance charge on their most recent payday loan reasonably accurately. By far, most customers had perceptions of the cost of payday loans relative to fees that payday loans are often used to avoid, and many perceived payday loans to be relatively expensive. These findings suggest that customers may weigh costs of alternatives in their decisions. That such fees are generally stated as dollar amounts or add-on rates rather than APR equivalents may explain why customers recalled the finance charge rather than the APR for their most recent payday loan.

Situational Factors. Use of payday loans is determined more by unplanned events than

15. See Durkin (2000) for a discussion on the use of awareness zones to assess consumer knowledge.

16. Percentages of customers responding that they did not know whether payday loan costs were more or less expensive than returned check or late fees were small. Most payday customers had experiences with these types of fees. Sixty-eight percent of customers had written checks later returned for insufficient funds in the past year, and more than a quarter had made late payments of 60 d or more on debts (Elliehausen and Lawrence, 2001).

TABLE 3
Availability of Bank Cards and Cost of Payday Advances

Panel A: Use of Bank Credit Cards				
	Payday Advance Customers (%)			All Adults (%)
Has bank cards	56.5			72.5
If yes, how many bank cards				
One	39.6			37.7
Two	33.5			29.3
Three	13.9			13.0
Four or more	13.0			20.1
Payment practices on bank cards				
Almost always pays full balance	25.1			48.8
Sometimes pays full balance	20.3			20.7
Hardly ever pays full balance	54.6			30.4
Refrained from using bank card in past year because credit limit would have been exceeded	60.8			na

Panel B: Cost of Payday Advance Relative to Cost of				
	Higher (%)	Same (%)	Lower (%)	Do Not Know (%)
Returned check fees	43.6	27.6	22.3	6.6
Late fees on rent (mortgage)	40.8	22.0	21.6	15.7
Late fees on credit card or other consumer debt	33.5	29.0	24.4	13.1

na, not available.

by the characteristics of the customer or the customer's financial circumstances. In the survey, nearly two-thirds of customers reported unexpected expenses or shortfalls in income as the reason for their most recent payday loan sequence.¹⁷ A high debt payment burden may make a consumer vulnerable to unplanned events, but many, if not most, consumers with high debt payment burdens do not experience unplanned events that are severe enough to cause financial distress, which might lead them to use payday loans. When such distress occurs, the urgency of the problem would dispose consumers to a relatively short decision process.

Consideration of Alternatives. Payday customers have few alternatives available to them. Only 16.0% reported having sufficient funds in checking and savings accounts at the time of their most recent advance (numbers not in

table). Considering the small size of most payday loans (typically \$100–\$300), it is likely that payday customers have very limited liquid assets, which provide high subjective yields. Thirty-eight percent of customers considered other sources, mostly depository institutions or finance companies, instead of a payday advance. This finding is not surprising since all customers had checking accounts and nearly all had other consumer debt. Only a small percentage (6.2%) considered a credit card, although 56.5% of payday customers have bank cards.

The infrequent consideration of bank cards is worth additional discussion. Of payday customers having bank cards, 39.6% have only a single bank card and another 33.5% have just two cards (Table 3). Thus, the percentage of payday customers having only one or two cards is much larger than percentage of bank card holders overall. Even if the average credit line per card was the same for all cardholders (unlikely), payday customers may still have less credit availability than other bank card holders since accounts can be added sequentially to increase the amount of available credit (Bizer and DeMarzo, 1992). Moreover, many

17. This finding probably understates the importance of unplanned events as a stimulus for using payday loans since the survey was conducted shortly after the Christmas holiday, a time when consumers have a relatively high level of planned expenditures. Also use of payday loans for planned expenses such as rent or monthly bills may have been precipitated by earlier unplanned expenses.

payday customers borrowed heavily against their limits. As mentioned in a previous section, 60.8% of payday customers with bank cards refrained from using a bank card in the past year because their credit limit would have been exceeded.

The large percentage of payday customers without bank cards is noteworthy. Customers' ownership of bank accounts and experience with mainstream credit suggests that bank card holding should be higher. Past problems may have caused some payday customers to be closed out of the bank credit market, but subprime bank credit cards are available for many consumers with impaired credit histories. The expansion of bank card holding even among lower income families suggests that availability is only part of the answer. It is likely that many payday customers do not have bank cards because they fear that they lack self-control to repay revolving debt. Such behavior is often called precommitment. Katona (1975) discussed use of credit contracts to enforce discipline and provided empirical evidence.¹⁸ More consumers have favorable attitudes toward instalment buying than using bank cards, and about half of all consumers believe that the use of credit cards is bad (Durkin, Elliehausen, and Staten, forthcoming), suggesting that many such consumers exist. Payday loans provide discipline, albeit at a high price, because the contract requires them to repay the entire amount at maturity.

Patterns of Use. The range in customer usage of payday advances during the calendar year 2001 was wide. At the lower end of use, a little more than a third of customers had four or fewer advances, which includes both new credit and renewals (Panel A of Table 4). Renewals may be either a rollover, in which the customer renews the advance by paying only the finance charge, or a same-day advance, where the borrower takes out another loan on the same day he repays an outstanding advance in full. At the high end, 22.5% of customers had a total of 14 or more payday advances in the past 12 mo prior to the survey. Most payday customers did not renew advances very often. A quarter of borrowers did not

renew any payday advance in the previous 12 mo, and 35.0% had one to two or three to four renewals. Some payday customers did renew frequently, however. Nine percent of customers had 9–13 renewals in the past 12 mo, and 10.4% had 14 or more renewals.

These statistics display a dichotomy in payday loan usage. Almost 52% of customers used advances six or fewer times per year. But the remaining 48% of borrowers had seven or more advances during the year. The higher frequencies imply substantial periods of time over which payday credit is outstanding. This characteristic is confirmed in Panel B of Table 4. The longest consecutive sequence of payday advances for 27.6% of customers was 2 wk or less, and the longest sequence for another 29.0% of payday customers was 3–4 wk. However, for almost one-fifth of customers, the longest sequences were greater than 2 mo. Nine percent of payday advance customers had their longest sequences lasting 9–13 wk, and another 10.0% had sequences of 14 or more weeks. Overall, the majority of consumers use advances infrequently or moderately. Over half of customers' longest consecutive sequence of advances was a month or less. These findings suggest that many borrowers do use payday advances regularly for short periods of time.

A small percentage of consumers may obtain a payday loan, repay, and not borrow again. However, once a consumer has decided to get a payday loan, he may well decide to use payday loans again. Patterns of subsequent use vary. The consumer may renew an existing loan at his next payday because his financial situation has not sufficiently improved to allow him to repay the loan. Instead, the consumer may be able to repay the loan but remains vulnerable to unplanned events. Unexpected expenses or shortfalls in income may occur again, and the consumer may resort to further payday loans. This result would be especially likely to occur if the consumer had been satisfied with previous experience. Evidence on consumer decision processes indicates that consumers satisfied with previous experiences often make subsequent purchases without additional deliberation or consideration of alternatives (Engel, Blackwell, and Miniard, 1997). Evidence in Panel A of Table 4 indicates that subsequent use varies from a small number of payday loans during the past year to 14 or more payday advances.

18. For more recent work dealing with precommitment, see Thaler and Shefrin (1981) who developed an economic model for self-control. Bertaut and Haliassos (2001) have applied such a self-control model to credit card borrowing behavior.

TABLE 4
Usage of Payday Advances

Panel A: Total Number of Advances, New Advances, and Renewals in the Past 12 mo			
	Total Advances (%)	New Advances (%)	Renewals (%)
None	—	—	25.1
1–2	15.6	35.5	21.1
3–4	19.2	31.4	13.9
5–6	16.9	15.3	10.4
7–8	10.3	7.0	9.6
9–13	15.6	6.7	9.4
14 or more	22.5	4.2	10.4

Panel B: Length of Longest Sequence of Consecutive Advances in the Past 12 mo	
2 wk or less	27.6
3–4 wk	29.0
5–6 wk	10.4
7–8 wk	14.5
9–13 wk	8.6
14 or more weeks	10.0

Panel C: Use of Different Payday Advance Companies in the Past 12 mo		
	Payday Advance Customers (%)	Customers using More Than One Company (%)
Used more than one company	47.0	100.0
Number of companies used		
Two	30.0	63.7
Three	11.1	23.6
Four or more	5.9	12.6
Paid off one company with proceeds of an advance from another company	16.5	35.2

Assuming a 2-wk average term, this amounts to owing payday advances for half of the year or longer.

Forty-seven percent of payday borrowers obtained credit from more than one company (Panel C of Table 4). Of the customers using more than one company, 63.7% used two, 23.6% three, and 12.6% four or more lenders. One motive for using more than one company appears to be to extend the period of time over which the debt is outstanding. A little more than a third of customers who used more than one firm obtained an advance at one company to pay off a loan at another company at least once during the previous 12 mo. The remaining two-thirds used more than one company for other reasons. Some customers may use multiple payday companies sequentially like using different credit cards to increase the amount of debt or availability of credit (Bizer and DeMarzo, 1992). Customers may also select different companies because the location

of each company may be convenient at different times. The small dollar amounts of the finance charge and expected benefits for most payday transactions probably do not justify incurring much transportation cost.

Post-Purchase Evaluation. Overall, the survey respondents had very favorable attitudes toward payday companies. By far, most survey respondents were satisfied with their most recent new payday advance. Forty-two percent of customers were very satisfied with their most recent new advance, and 33.0% were somewhat satisfied (Table 5). Only 12.2% of customers expressed any level of dissatisfaction, about half of whom were very dissatisfied. The survey instrument probed further into the dissatisfied group to ascertain the reason for their discontentment. High cost was overwhelmingly the reason for customers' dissatisfaction. A high interest rate was the most frequently mentioned item, with 30.8%

of dissatisfied customers mentioning this reason. A high finance charge or just high cost was also frequently cited (9.6% and 21.2%, respectively). In total, 61.6% of disgruntled customers mentioned some aspect of cost as a reason for the dissatisfaction. Other specific problems were infrequent. Collection problems were mentioned by 7.7% of dissatisfied customers. Insufficient or unclear information was each cited by 3.9% of respondents. And only 1.9% of these borrowers mentioned difficulty in being able to get out of debt as the reason for their dissatisfaction.

Customers' satisfaction with their most recent advance is reflected in their positive attitudes toward payday advances generally and their opposition to proposals for regulation that directly restricts availability. As shown in Table 6, approximately 92% of borrowers strongly agreed or somewhat agreed with the statement "Payday advance companies provide a useful service to consumers." Three percent of customers somewhat disagreed that payday companies provide a useful service, and only 4.7% strongly disagreed. The overwhelmingly favorable response to this statement provides evidence that payday companies serve a real economic need for their customers.

One proposal for regulation would limit the number of payday loans a consumer can take

out in a year in order to address the alleged problem that consumers end up using payday advances as long-term credit. When asked about such a limitation, more than two-thirds of payday customers strongly disagreed or somewhat disagreed. Another proposed remedy to this alleged problem would limit the number of times a payday loan can be renewed without a break. Responses to this proposal were similar to the previous one. Sixty-two percent of borrowers strongly disagreed or somewhat disagreed that the number of consecutive renewals should be limited.

A form of regulation with which customers generally agreed was limiting the fees payday lenders are allowed to charge. Three of four customers strongly agreed or somewhat agreed that the government should regulate the fees charged by payday companies. Considering the very favorable attitude toward payday advances and opposition to limiting the number of payday loans, it is likely that few of these customers would agree to new limits if they were personally prevented from obtaining credit. Instead, this attitude of favoring price regulation seems to reflect a general sentiment that payday borrowers would prefer lower prices as well as a lack of understanding of the role of competition in limiting prices or the effects of binding constraints on credit availability. Such feelings are widespread and not unique to payday lending. Durkin (2000), for example, found bank card holders expressing similar opinions that credit card interest rates were too high.

TABLE 5

Satisfaction with Most Recent New Advance

Level of Satisfaction	Customers Responding (%)
Very satisfied	42.2
Somewhat satisfied	33.0
Neither satisfied nor dissatisfied	12.5
Somewhat dissatisfied	6.3
Very dissatisfied	5.9
Total	100.0
If dissatisfied, the reasons for dissatisfaction	
High interest rate	30.8
High finance charge	9.6
High cost, not ascertained whether finance charge or interest rate	21.2
Collection problems	7.7
Insufficient or unclear information	3.9
Not able to renew or extend	3.9
Too difficult to get out of debt	1.9
Other	21.2
Total	100.0

VIII. FURTHER EXPLORATORY ANALYSIS

Frequent use of payday loans is not generally associated with customers' financial characteristics, but there are a few exceptions. We estimated logistic regressions to predict frequent use of payday loans, defined as 14 or more payday loans during the past year, as a function of customer and financial characteristics.¹⁹ The results, presented in Table 7, are representative of the findings. The estimated regression was statistically significant, but only a few characteristics were statistically significant. Past payday use (measured by use

19. Explanatory variables included the variables reflecting attitudes toward credit; family life-cycle stage and income; knowledge, awareness of credit costs, and financial experience; and financial management skills and behavior.

TABLE 6
Attitudes Toward Payday Advances

	Strongly Agree (%)	Somewhat Agree (%)	Somewhat Disagree (%)	Strongly Disagree (%)	Do Not Know (%)
Payday advance companies provide a useful service to consumers	53.9	38.2	2.8	4.7	0.5
The government should limit the number of payday advances one can get in a year	17.1	12.4	18.7	50.4	1.4
The government should limit the number of times a payday advance can be renewed without a break	19.7	16.6	18.7	42.9	2.1
The government should limit the fees charged by payday advance companies	55.5	19.7	11.5	11.9	1.4

of payday loans for more than 2 yr) was positively related to frequent use. Favorable attitudes toward credit (measured by agreement with the statement that most people benefit from the use of credit) were negatively related to frequent use. These findings suggest that frequent users have long-term difficulty in managing finances and their less favorable attitudes toward credit reflect difficulties in handling credit.

Logistic regressions also show that frequent bank card revolvers (bank card holders who hardly ever pay in full) are less likely to be frequent payday loan users than customers who revolve sometimes or customers who do not have revolving credit accounts. However, bank card holders who did not use bank cards during the past year because the limit would have been exceeded were more likely to be frequent users. Thus, bank card credit appears to be a substitute for payday loans, but customers frequently resort to payday loans when revolving credit is no longer available.

Demographic characteristics of customers generally were not significant. This finding is not because of intercorrelation among explanatory variables. These variables did not distinguish between frequent and less frequent use.²⁰ For example, college graduates were nearly equally represented among frequent and less frequent users (23% and 21%, respectively), and the difference in the percentage of blacks among frequent and less frequent users (29% and 22%, respectively) is relatively small.

Demographic variables had little predictive value. Only two life-cycle variables were statistically significant in some regressions (not reported in Table 7). Younger customers (age less than 45 yr) without children were less likely to be frequent users than customers with children, and older customers without children were more likely to be frequent users. The finding that younger customers without children were less likely to be frequent users is consistent with theoretical expectations about demand for high-price credit. Older customers without children are small percentage of payday loan customers (and, as mentioned, much less likely to be payday loan borrowers than their proportion in the population). However, the regression models suggest that those who do use payday loans may have financial difficulties that cause them to use payday loans frequently.

Awareness about payday loan costs is not significantly related to frequency of use. This result is not unexpected. Since almost all customers were aware of the finance charge for their last payday loan, awareness of the finance charge did not distinguish frequent from infrequent borrowers (numbers not in table). Customers who were aware of the APR for the last payday loan (about a fifth of customers) were not significantly less likely to use payday loans frequently than those who were unaware of the APR. Late payments on other credit obligations in the past year were not significantly related to frequency of use nor were returned checks. These problems were common for frequent and less frequent users. More detailed information on the extent of customers' financial circumstances, which might distinguish frequent from less frequent users, was not available.

20. Results were not very sensitive to model specification. A favorable attitude toward credit, long-term use, and the two bank card variables discussed above were almost always significant. Except for two life-cycle variables, demographic variables were hardly ever significant.

TABLE 7
Logistic Regression Predicting Frequent Use of Payday Loans

Variable	Mean	Coefficient (SE)
Agree that most people benefit from use of credit (dummy variable)	0.820	-0.863 (0.409)**
Agree that overspending is the fault of consumers (dummy variable)	0.808	0.599 (0.429)
Agree that too much credit is available today (dummy variable)	0.558	0.187 (0.320)
Agree that payday loan companies provide a useful service (dummy variable)	0.924	0.199 (0.594)
Less than 45 yr of age, no children (dummy variable)	0.177	-0.783 (0.515)
45 yr of age or older, has children (dummy variable)	0.050	0.248 (0.703)
45 yr of age or older, no children (dummy variable)	0.180	0.538 (0.392)
Family income less than \$25,000 (dummy variable)	0.227	0.320 (0.399)
Family income \$50,000 or more (dummy variable)	0.252	0.137 (0.390)
Education less than high school diploma (dummy variable)	0.054	0.314 (0.636)
College degree (dummy variable)	0.215	0.238 (0.393)
Aware of APR for last payday loan (dummy variable)	0.120	0.108 (0.475)
Credit union member (dummy variable)	0.476	0.107 (0.331)
Used payday loans for more than 2 yr (dummy variable)	0.180	1.592 (0.371)***
Had savings that could have been used instead of payday loan (dummy variable)	0.155	-0.298 (0.474)
Had returned checks in past 12 mo (dummy variable)	0.129	0.408 (0.440)
Had late payments on mortgage or consumer debts in past 12 mo (dummy variable)	0.208	0.082 (0.391)
Had bankruptcy in past 5 yr (dummy variable)	0.155	0.093 (0.428)
Has bank cards, usually pays balances in full (dummy variable)	0.138	-0.469 (0.552)
Has bank card, hardly ever pays balances in full (dummy variable)	0.287	-1.675 (0.514)***
Does not have revolving credit account (dummy variable)	0.385	0.055 (0.467)
Credit request turned down or limited in past 5 yr (dummy variable)	0.730	0.171 (0.416)
Did not use a bank card in past 12 mo because credit limit would have been exceeded (dummy variable)	0.338	0.737 (0.452)*
Thought of applying for credit in past 5 yr but did not because feared turndown (dummy variable)	0.700	0.613 (0.391)
Black (dummy variable)	0.240	0.300 (0.360)
Hispanic (dummy variable)	0.054	-1.741 (1.104)
Female (dummy variable)	0.552	0.465 (0.339)
Intercept	1.000	-2.497 (0.065)***
Memo		
Number of observations		317
Mean of dependent variable		0.237
Likelihood ratio		60.976
Degrees of freedom		27

Notes: Means may differ from statistics reported elsewhere because of missing values in variables used in logistic regressions.

*Significantly different from zero at the 10% level; **significantly different from zero at the 5% level; ***significantly different from zero at the 1% level.

How long consumers continue to use payday loans is not documented. Most consumers having high debt payment burdens at a point in time repay debts or receive increases in income, which reduce debt payment burdens and vulnerability to financial distress.²¹ These consumers may use payday loans, perhaps fre-

quently, for a short time period and then stop using it. Other consumers may lack self-control or have poor financial management skills that cause them to live from paycheck to paycheck for extended periods of time. Some payday customers appear to have this characteristic. A fifth of payday customers responding to the survey had used payday loans for periods of time longer than 2 yr (numbers not in table).

21. For evidence on persistence of high debt payment burdens, see Avery, Elliehausen, and Kennickell (1987).

XI. CONCLUSIONS

Despite being a relatively new and innovative form of consumer lending, the payday advance transaction is growing in popularity. Nevertheless, this type of borrowing is highly controversial and not yet well understood. Critics charge that payday companies conduct predatory lending that takes advantage of lower income groups that lack lower price alternatives. Industry representatives counter that these services provide real economic benefits to borrowers and meet an unsatisfied need for small consumer loans ignored by more traditional lenders. Regardless of which view one holds, there is no question that the rapid growth of the payday industry demonstrates a strong consumer demand.

This article expands our limited knowledge of payday lending by adopting a standard economic model of consumer credit use. Drawing on an extensive national survey, the evidence indicates that payday customers are predominantly the early life-cycle, moderate income, credit constrained consumers, which economic theory suggests may benefit from relaxation of credit constraints through use of high-price credit.

A cognitive model of decision making is then used to assess the customers' decision process. The survey shows that nearly all borrowers were aware of the high finance charge for payday credit but not the APR. Their awareness of the cost of payday advances relative to returned check and late payment fees that payday advances are often used to avoid suggests that customers may weigh costs of alternatives in their decisions. That such fees are generally stated as dollar amounts or add-on rates rather than APR equivalents may explain why customers recalled the finance charge rather than the APR for their most recent payday loan.

Most customers used other types of consumer credit and therefore have previous experience with credit and creditors. Many have levels of education that are associated with awareness of APRs for different types of consumer credit. A large percentage considered alternatives to payday loans; however, evidence suggests that many customers may have had difficulty obtaining additional credit from mainstream lenders, especially on an unsecured basis. Most customers used payday advances only a few times during the past year,

typically for less than a month at a time. Thus, the behavior of customers was generally consistent with the intended use of the product, and customers were aware of the price of the product and showed signs of deliberation in their decision to use payday advances.

These findings suggest that payday advances give consumers a little control over their financial affairs they otherwise would not have. This may explain customers' positive attitudes toward payday loans and high levels of satisfaction, despite the high cost relative to loan size compared to other forms of traditional credit.

As is often the case, opportunity for some consumers may be accompanied by harm to others. A relatively small percentage of high frequency users rely on payday loans for an extended period of time. This behavior is not necessarily harmful because some consumers may need a longer period of time to improve their situation. However, reliance on payday loans for an extended period of time seems contrary to the short-term financing intention of the product and may exacerbate rather than relieve financial problems some consumers face. More research needs to be conducted on this important subgroup of payday customers.

For the critics of the payday loan industry, totally curtailing payday lending may actually be a more harmful public policy for some low- and middle-income people who lack viable alternatives in a moment of great need. The majority of payday customers do not abuse the short-term nature of this form of lending and use it appropriately. Furthermore, as the online gaming industry has recently demonstrated, banning a service locally that is in demand only drives the business offshore without government regulation and no taxes. To address concerns about prices, public policy should be concerned with eliminating barriers to entry and promoting competition rather than limiting prices or otherwise restricting availability.

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