# The use of pawnshops in the US

**Objective**

In a pawnshop, a lender takes physical possession of a pawned item and gives the borrower a small fraction of what the item is worth (Avery & Samolyk, 2011). If the borrower does not repay the loan, the pawnshop can sell the item, generally for more than the value of the loan. Pawnshop loans are, along with payday loans, rent-to-own loans and refund anticipation loans, a part of the so-called Alternative Financial Services (AFS) and outside the mainstream financial sector, represented by banks and other financial firms.

The pawnbroker's only risk is that s/he will not be able to sell the item for at least as much as the borrower received from the pawn broker. The pawnbroker becomes a "lender of last resort" for Americans who pawn items (Caskey & Zikmund, 1990; Goldin & Homonoff, 2013; Lusardi, Schneider & Tufano, 2011; Schackman & Tenney, 2006).

**Significance**

In this study the authors analysed determinants of the use of pawnshops in the US. The analysis examined the influence of financial literacy and a set of the respondents' financial characteristics on use of a pawnshop, when controlling for personal characteristics and the availability of pawnshops in the consumers' geographic area.

This study is relevant in at least four ways. First, there is little previous research about pawnshops, perhaps due to the lack of available data. Avery and Samolyk (2011), Carter (2012), Caskey and Zikmund (1990) and Caskey (1991) all called for additional research. Second, the AFS market, and more specifically pawnshops, are growing in relevance. The total number of pawnshops in the US has increased from around 5,000 in 1985 (Goldin & Homonoff, 2013) to 13,500 in 2011 (Avery & Samolyk, 2011). The Federal Deposit Insurance Corporation (FDIC) estimated the AFS industry to be worth at least $320 billion in transactional services, as reported by Lusardi and De Bassa Scheresberg (2013), while Mills and Monson (2013) reported that the total households with one or more members having ever used one or more non-bank credit products rose from 11.8% in

2009 to 14.2% in 2011. In the same study, the authors highlighted the increased frequency of pawnshop loans within the AFS industry.

A third motivation behind this study is to identify policy recommendation, taking into account that the customers of pawnshops may be unbanked. A final reason for this research relates to improved understanding of why consumers use pawnshops, given their high cost. Previous studies reported that the average amount of a pawnshop loan was $80 (Avery & Samolyk, 2011) with Annual Percentage Rates (APRs) of more than 200% (Avery & Samolyk, 2011). Carter (2012) estimated the average APR for two-week pawnshop loans to be close to 650%.

**Method**

The data were from two sources. The first was the FINRA National Financial Capability Study (NFCS) of 2012 which used data from a sample of more than 25,000 American adults. The second source was the US Census Bureau which provided information about the number and distribution of pawnshops in the US and the population of each of the 50 states and the District of Columbia.

A set of regression analyses were used to investigate determinants of the use of pawnshops. Three different dependent variables were used: (1) the number of times a respondent reported using a pawnshop in the last five years, (2) if a respondent reported ever using a pawnshop in the last five years, and (3) if a respondent reported using a pawnshop at least twice in the last five years.

The independent variables were five measures of financial difficulty and three measures of financial literacy. The measures of financial difficulty were whether the respondent had filed for bankruptcy in the last two years, been involved in a foreclosure in the last two years, experienced an unexpected large drop in income in the last 12 months, been late on mortgage payments in the last two years, and reported difficulty covering expenses, and agreed they have "too much debt right now." The three measures of financial literacy were based on correct responses to knowledge questions about compound interest, the influence of inflation on purchasing power, and the relative

risk of a single share of stock vs. a stock mutual fund.[1] In addition, variables were included to determine the influence of the use of financial products in the formal financial system – checking accounts, savings accounts, and credit cards – on the use of pawnshops. Control variables were age, gender, ethnicity, education, occupation, and income as well as the number of pawnshops in the local community.

**Results**

The main results from the analysis can be summarized as follows.[2] Having used a pawnshop at least one time was positively related with financial difficulties (bankruptcy, foreclosure, difficulties in covering expenses, large drop in income) but negatively related with higher financial literacy and having used mainstream financial products such as checking accounts and saving accounts. The relationship with the number of credit cards was not linear. Having a small number of credit cards (1, 2 or 3 cards) was negatively related to having used a pawnshop, while having more than three cards was positively related. Among the control variable, pawnshop users were those with very low income and little education, males, and younger respondents. Easy access to pawnshops increased the likelihood of use, even after controlling for other variables.

The relationship between financial difficulties and the use of pawnshops, which was suggested by previous studies, is coherent with the nature of pawnshops as a "lender of last resort." Experiences such as bankruptcy or foreclosure have a negative impact on credit scores and other credit risk measures, and consequently some pawnshop users may no longer be eligible for credit from mainstream lenders. The positive relationship with a higher number of credit cards could indicate that pawnshop users have maximized their use of that mainstream credit option. The fact that people with higher financial literacy tend to use less pawnshops less frequently, especially when financial literacy was measured as knowledge about compound interest and inflation, supports the hypothesis that use of an expensive financial service such as a pawnshop cannot be explained by traditional measures of financial knowledge.

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[1] Only the first set of regression analyses is reported in this paper but all three will be reported at the conference.
[2] Details about the empirical results are available in Table 1 in the appendix.

**Conclusions/Relevance**

This paper provides evidence that users of pawnshops are different in important ways from those in the mainstream financial sector. The high cost of the pawnshop loans, associated with the presence of financial difficulties, suggests that the elasticity of the demand in this market is extremely low, giving pawnbrokers the power to fix the price of their financial service close to the limits of the market, which in some states may be imposed by law. A first policy recommendation of the paper concerns the positive return of investment devoted to improved financial literacy specific to the use of the AFS. What consumers need to know to effectively use this sector is likely somewhat unique to that sector and not what is traditionally taught regarding mainstream financial services. For example, how could a consumer know if s/he is receiving fair value for a pawned item?

A second suggestion for policy makers and consumer protection authorities regards the need to monitor the market to identify practices of predatory lending. Some limits to the number of times that a pawnshop loan can be renewed/revolved could mitigate the risk of a three-digit APR. Such a limit, compared with more harsh regulatory responses, allows consumers to continue to use pawnshops as lenders of last resort but at more reasonable costs. Regulation at the federal level may be more appropriate. Policy must be coordinated; otherwise, we risk pushing consumers to another less-regulated sector of the Alternative Financial Services market.

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**APPENDIX - Table 1: Results from Logistic Regressions**

| Use of Pawnshops (at least once in the last 5 years) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Variable** | **coeff.** | **p-value** | **coeff.** | **p-value** | **coeff.** | **p-value** | **coeff.** | **p-value** |
| **Gender** | | | | | | | | |
| gender (male =1) | **.341** | **0.000*** | **.437** | **0.000*** | **.449** | **0.000*** | **.426** | **0.000*** |
| **Age** | | | | | | | | |
| age=18-24 years | (Reference group) | | (Reference group) | | (Reference group) | | (Reference group) | |
| age=25-34 years | **-.156** | **0.036**** | -.123 | 0.101 | **-.261** | **0.001**** | **-.251** | **0.002**** |
| age=35-44 years | **-.356** | **0.000*** | **-.270** | **0.002**** | **-.399** | **0.000*** | **-.376** | **0.000*** |
| age=45-54 years | **-.743** | **0.000*** | **-.607** | **0.000*** | **-.724** | **0.000*** | **-.698** | **0.000*** |
| age=55-64 years | **-1.169** | **0.000*** | **-1.020** | **0.000*** | **-1.132** | **0.000*** | **-1.113** | **0.000*** |
| age=65+ years | **-1.912** | **0.000*** | **-1.728** | **0.000*** | **-1.694** | **0.000*** | **-1.660** | **0.000*** |
| **Ethnicity** | | | | | | | | |
| ethnicity (1=white) | **-.241** | **0.000*** | **-.200** | **0.000*** | **-.192** | **0.001**** | **-.182** | **0.002**** |
| **Job** | | | | | | | | |
| job=Self employed | (Reference group) | | (Reference group) | | (Reference group) | | (Reference group) | |
| job=Work full-time for an employer [or the military] | **-.350** | **0.000*** | **-.354** | **0.000*** | **-.276** | **0.005**** | **-.259** | **0.008**** |
| job=Work part-time for an employer [or the military] | -.164 | 0.128 | -.175 | 0.106 | -.159 | 0.168 | -.118 | 0.308 |
| job=Homemaker | -.002 | 0.979 | -.026 | 0.817 | .045 | 0.708 | .060 | 0.625 |
| job=Full-time student | **-.469** | **0.000*** | **-.432** | **0.001**** | **-.412** | **0.002**** | **-.384** | **0.004**** |
| job=Permanently sick, disabled, or unable to work | .051 | 0.666 | .009 | 0.940 | .014 | 0.907 | .047 | 0.712 |
| job=Unemployed or temporarily laid off | .045 | 0.664 | .025 | 0.807 | -.182 | 0.103 | -.163 | 0.146 |
| job=Retired | **-.447** | **0.001**** | **-.465** | **0.001**** | **-.256** | **0.072*** | **-.250** | **0.080*** |
| **Income** | | | | | | | | |
| income=Less than $15,000 | (Reference group) | | (Reference group) | | (Reference group) | | (Reference group) | |
| income=At least $15,000 but less than $25,000 | **.169** | **0.027**** | **.187** | **0.015**** | **.249** | **0.002**** | **.247** | **0.002**** |
| income=At least $25,000 but less than $35,000 | .043 | 0.602 | .072 | 0.387 | **.246** | **0.005**** | **.252** | **0.004**** |
| income=At least $35,000 but less than $50,000 | **-.159** | **0.058*** | -.108 | 0.201 | .141 | 0.120 | **.165** | **0.072*** |
| income=At least $50,000 but less than $75,000 | **-.593** | **0.000*** | **-.527** | **0.000*** | -.139 | 0.157 | -.101 | 0.306 |
| income=At least $75,000 but less than $100,000 | **-.663** | **0.000*** | **-.579** | **0.000*** | -.133 | 0.269 | -.093 | 0.441 |
| income=At least $100,000 but less than $150,000 | **-1.167** | **0.000*** | **-1.070** | **0.000*** | **-.607** | **0.000*** | **-.550** | **0.000*** |
| income=$150,000 or more | **-.849** | **0.000*** | **-.784** | **0.000*** | **-.399** | **0.037**** | **-.326** | **0.091*** |
| **Education** | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| education=Did not complete high school | (Reference group) | | (Reference group) | | (Reference group) | | (Reference group) | |
| education=High school graduate - regular high school diploma | **-.546** | **0.000*** ** | **-.493** | **0.000*** ** | **-.362** | **0.000*** ** | **-.355** | **0.000*** ** |
| education=High school graduate - GED or alternative credential | -.100 | 0.295 | -.054 | 0.576 | .031 | 0.758 | .035 | 0.729 |
| education=Some college | **-.494** | **0.000*** ** | **-.357** | **0.000*** ** | **-.219** | **0.009** ** | **-.223** | **0.008** ** |
| education=College graduate | **-.538** | **0.000*** ** | **-.378** | **0.005** ** | -.207 | 0.149 | -.152 | 0.292 |
| education=Post graduate education | **-.608** | **0.000*** ** | **-.409** | **0.021** ** | **-.422** | **0.031** ** | **-.390** | **0.048** ** |
| **Marital status** | | | | | | | | |
| marital status=Married | (Reference group) | | (Reference group) | | (Reference group) | | (Reference group) | |
| marital status=Single | **.127** | **0.052*** | **.123** | **0.060*** | **.135** | **0.052*** | **.173** | **0.013** ** |
| marital status=ùSeparated | **.385** | **0.021** ** | **.351** | **0.037** ** | .193 | 0.277 | .230 | 0.196 |
| marital status=Divorced | **.357** | **0.000*** ** | **.364** | **0.000*** ** | **.362** | **0.000*** ** | **.366** | **0.000*** ** |
| marital status=Widowed/widower | **.563** | **0.000*** ** | **.551** | **0.000*** ** | **.581** | **0.000*** ** | **.581** | **0.000*** ** |
| **Children** | | | | | | | | |
| children (#) | **-.113** | **0.000*** ** | **-.111** | **0.000*** ** | **-.077** | **0.000*** ** | **-.078** | **0.000*** ** |
| **Financial Literacy** | | | | | | | | |
| FL=compound interest | | | **-.219** | **0.000*** ** | **-.164** | **0.004** ** | **-.155** | **0.007** ** |
| FL=inflation | | | **-.346** | **0.000*** ** | **-.275** | **0.000*** ** | **-.269** | **0.000*** ** |
| FL=stock mutual fund | | | **-.213** | **0.000*** ** | **-.139** | **0.012** ** | **-.140** | **0.013** ** |
| **Credit access** | | | | | | | | |
| checkingaccount | | | | | **-.552** | **0.000*** ** | **-.551** | **0.000*** ** |
| savingaccaount | | | | | -.089 | 0.123 | -.069 | 0.239 |
| creditcard(4 or plus) | | | | | **.318** | **0.000*** ** | **.311** | **0.000*** ** |
| **Financial difficulties** | | | | | | | | |
| bankruptcy | | | | | **.640** | **0.000*** ** | **.635** | **0.000*** ** |
| foreclosure | | | | | **.664** | **0.000*** ** | **.689** | **0.000*** ** |
| coverexpenses | | | | | **.264** | **0.000*** ** | **.280** | **0.000*** ** |
| largedropincome | | | | | **.426** | **0.000*** ** | **.424** | **0.000*** ** |
| lateonmortgage | | | | | **-.117** | **0.001** ** | **-.118** | **0.001** ** |
| toomuchdebts | | | | | **.118** | **0.000*** ** | **.120** | **0.000*** ** |
| **Pawnshop density** | | | | | | | | |
| pawn_population | | | | | | | **.942** | **0.000*** ** |
| *constant* | .403 | 0.006 | .530 | 0.000 | -.813 | 0.000 | -1.218 | 0.000 |
| # Obs. | 13,073 | | 13,073 | | 12,749 | | 12,749 | |
| Pseudo R-squared = | 0.1282 | | 0.1371 | | 0.1913 | | 0.1969 | |