

The FTC looks at RTO

A report on the report by Ed Winn III

In April, the Federal Trade Commission released its long-awaited Survey of Rent-To-Own Customers. The industry had been aware of the pending study since last May when the White House announced a consumer protection initiative broadly labeled "Expand the Consumer's Right to Know," which included an examination of and possible regulatory recommendations for the rental-purchase industry.

The resulting FTC report shows unusual insight into how the industry works and, overall, with one possible exception, is balanced, objective and fair. The FTC commissioned a random-dial telephone survey of actual rental-purchase customers similar to the two telephone surveys conducted by America's Research Group and Britt Beemer at the behest of APRO in 1994 and 1999. The FTC surveyors called over 12,000 homes in order to interview 532 customers who had entered into at least one rental-purchase transaction during the past five years. The America's Research Group surveys polled a similar-sized group of actual rental-purchase customers, 600, in its 1999 survey.

The FTC study had three goals: (1) to distinguish the characteristics of rental-purchase customers from those who do not use the transaction; (2) to determine how often rental-purchase transactions go to term; and (3) to determine whether abusive collection practices are widespread in the industry, as charged by consumer advocates.

The FTC goals differ sharply from the industry-commissioned surveys, whose goals were to measure the rental-purchase customer satisfaction levels about various aspects of the transaction. The FTC report, other than offering the results of its survey, is generally reticent either to praise or condemn industry practices, although a few of its findings do fly in the face of traditional industry criticism and can be fairly interpreted by industry supporters as official approval. The Beemer report, by contrast, offers a number of specific marketing recommendations based on its findings.

Based on the results of its survey, the FTC describes rental-purchase customers as "more likely to be African-American, younger, less educated, have lower incomes, have children in the household, rent their residences, live in the South and live in non-suburban areas."

The demographic profile derived from the FTC study differs from that found in the Beemer surveys. For example, the FTC study found that 73 percent of rental-purchase customers had a high school education or less. The Beemer studies found the percentage to be 60 percent. In the FTC study, 62 percent of rental-purchase customers rented their homes; in the Beemer study the percentage was 50 percent. The FTC study found 60 percent of rental-purchase customers had household incomes of less than \$25,000; in Beemer, 30 percent of households earned \$24,000 or less. Thirty-one percent of rental-purchase customers in the FTC survey were African Americans; in the Beemer studies, the percentage was 25 percent.

The studies also differed sharply over the kinds of merchandise rented by rental-purchase customers. The chart below shows the divergence between the studies relating to the kinds of products rented.

These differences go beyond mere statistical anomalies. The two groups sampled are simply different, as are the products they rented.

The differences, while material, do not render any of the studies invalid. These studies

profile a diverse population base - rental-purchase customers. The industry has had difficulty defining its own customer base because of this diversity. The variance in these studies points up the lack of homogeneity among rental customers. It varies company by company, store by store, and now statistical survey by statistical survey. It would be equally difficult to derive precise conclusions about people who drive cars or people who eat cheeseburgers.

The FTC study, as did the Beemer surveys, offers new insights into rental-purchase customers' attitudes and opinions about the transaction. No such study is intended to be definitive and the results of all such studies in the future will likely change as the industry continues to evolve with its products, services and methods of operation.

The FTC and Rent-to-own

The rental-purchase industry has had relations with the FTC dating back to the late '70s, at least. Before APRO was formed, several rental companies had meetings with FTC staff to explain how the business worked and to see if the FTC could offer some protection from suits being brought against rental companies for allegedly violating federal Truth-In-Lending laws.

In 1983, the FTC submitted testimony to the U.S. Senate on proposed rental-purchase legislation. At that time, the FTC did not have "specific data on the frequency of rental-purchase agreements in the marketplace or of abuses of lessors in rental-purchase transactions - " Ten years later, the FTC appeared before Representative Gonzalez' House Banking Committee and said much the same thing: "The Commission, however, has no independent information regarding RTO issues, and thus takes no view as to whether new federal legislation is necessary." The FTC also noted that it rarely receives complaints regarding RTO matters.

Chairman Gonzalez at the time publicly chastised the FTC for not coming down on the industry using the FTC Act, which gives the commission authority to regulate "unfair or deceptive acts and practices." The FTC representative noted for the committee that the commission received 41,000 consumer complaints in 1992, 82 of which dealt with leasing of any kind and perhaps one or two of which dealt with rental-purchase transactions. The implication was that the FTC was not persuaded, unlike Chairman Gonzalez, that the industry was necessarily doing anything wrong.

The FTC representative went on to note that much of the rental-purchase industry was made up of mom-and-pop operations. According to the FTC, "Expansive changes in the legal environment for this industry could impose compliance obligations that many such businesses could not easily meet. As a result, many such businesses could be forced to leave the market. These departures ultimately might harm rent-to-own consumers who rely on these small businesses in their neighborhoods and would be left with a less competitive industry."

The FTC is not a knee-jerk consumer protection organization and, indeed, it cannot be, because the FTC wears a lot of regulatory hats. The FTC has regulatory authority under 46 separate federal laws, which fall into two main categories: protecting consumers and insuring economic competition. The FTC has a lot of economists on staff to analyze the complicated business situations that call U.S. antitrust laws into play. Most of that analysis requires application of the "rule of reason," which means that they, as regulators first and, finally, the courts, if need be, must assess the costs and benefits of various decisions instead of instinctively leaping to a "pro-consumer," "liberal," "pro-business" or

"conservative" conclusion. This vigorous economic analysis on the antitrust side appears in the consumer protection side of the FTC and is evident all through the findings in the rent-to-own survey.

Rental-Purchase Customer Satisfaction

The biggest finding in the FTC study from the industry's point of view is that 75 percent of rental-purchase customers are satisfied with their experience with rental-purchase transactions. In the Beemer survey, this percentage was just over 80 percent. According to the FTC, here is what customers like: "the ability to obtain merchandise they otherwise could not; the low payments; the lack of a credit check; the convenience and flexibility of the transaction; the quality of the merchandise; the quality of the maintenance, delivery and other services; the friendliness and flexibility of the store employees; and the lack of any problems or hassles."

Most customers who are dissatisfied are unhappy with rental-purchase pricing. The Beemer survey found similar reasons for satisfaction and dissatisfaction.

Keep Rate

The most puzzling finding in the FTC study was that rental-purchase customers ended up owning 70 percent of the units they rented. The industry's own analysis of keep rate derived by dividing units delivered that went to ownership over a period of time by total units delivered over the same period of time have consistently yielded "keep rates" less than half of the FTC number. When rental-purchase customers in the Beemer surveys responded with a 50 percent keep rate percentage, the industry assumed that customers had forgotten units they had rented briefly and returned.

The industry's internal analyses were subjected to strict scrutiny because of the circumstances that gave rise to the analyses in the first place. It was during the industry's negotiations with the IRS over how to characterize rental-purchase transactions for tax purposes and, if the transaction was going to be deemed a lease, how to depreciate rental merchandise. The industry was prepared to go to court over the lease-versus-sale issue. In fact, there were two tax court cases pending when the Congress clarified the tax code in 1997 making rental-purchase transaction leases for tax purposes. Against the tracking data available in most companies which shows the keep rate for new merchandise to be under 25 percent and the keep rate for all merchandise to be under 35 percent, one can only assume again the imperfect memory of rental-purchase customers polled in the FTC survey.

The bright side of this finding is that the FTC found no evidence that customers were renting units for a long time and then "losing" them back to rental companies when they missed a payment. Critics are fond of accusing the industry of lying in wait for customers in the 77th week to fall a day behind so that the company can grab the unit back. The FTC study found that 90 percent of customers who rented for six months or more obtained ownership.

No Collection Abuse

The FTC answered its third inquiry (to determine whether abusive collection practices exist in the industry) emphatically in favor of the industry. "Abusive collection practices are not widespread and do not represent the typical experience of most rent-to-own customers who are late making a payment." And nearly half of rental-purchase customers surveyed were late at least once. This finding is a tribute to the patience and restraint that the industry consistently demonstrates in the collection end of the business and should do much to

portray the occasional horror story that makes its way into the media as what it is, an aberration, and in no way an indication of industry business practices.

FTC Policy Recommendations

The FTC did have some recommendations about how to regulate the industry. The clearest suggestion was for all rental stores to have price tags that include the total rental-purchase cost, the rental rate and other basic terms on products in the store. Rental-purchase statutes in 18 states require price tag disclosures and it is not known how widespread the practice is voluntarily among dealers in the other states. The FTC argues persuasively that consumers need this information while shopping and not after a decision to rent has been made. The FTC found the burden of complying with such a requirement to be minimal for dealers. As it happens, price tag disclosures is one of the provisions in the Jones bill currently pending in the U.S. House of Representatives and is a provision that the industry supports.

Because of the high keep rate found in its survey, the FTC acknowledges that some may want to regulate the transaction as a sale. However, the FTC urged caution about requiring an annual percentage rate disclosure in rental-purchase transactions. An interest rate disclosure has already proven difficult to regulate in automobile leases where there is a debt accrued. It would be no less difficult to require an interest rate disclosure in rental-purchase transactions where there is no debt. Problems include cash price variances and the valuation of the various services that make up the typical rental-purchase program. These are problems that the industry has understood for some time and that the FTC acknowledges in its report.

The FTC writes deftly of the difficulty of mandating a uniform cash price disclosure methodology for the industry. The study decimates the notion that dealers be required to disclose cash prices in their stores equal to "prevailing market prices," which has been a recent push from some consumer groups at the federal level and in a few states as well. The FTC discusses the operational difficulties dealers would have in conducting the needed surveys of other stores and concluded that these kinds of surveys "could be prohibitively expensive."

Rental-Purchase Profits

Another finding by the FTC, albeit an indirect one, was that rental dealers are not enjoying exorbitant profits as has been suggested by critics. The FTC was discussing the feasibility of imposing price restrictions on the industry, perhaps by requiring an APR disclosure and then limiting the amount of interest. The FTC noted that it was not charged with studying the industry's prices and profits. It did note, however, that there are few barriers to entering the rental-purchase business. "A new entrant would need little more than a storefront, a delivery truck and an inventory of household merchandise."

The FTC properly notes that excessive profits in an industry can only be maintained if there are significant barriers to entry, collusion or some type of anti-competitive behavior. The FTC did not discuss anti-competitive behavior, but rental dealers in most markets know how competitive the business is. Dealers know, finally, that rental rates are what they are because of the costs associated with running the business. The FTC implied as much.

Customers' Transportation and Finances

An important finding in the FTC study is that 84 percent of rental-purchase customers have

a car or truck. The FTC acknowledges that this finding refutes the argument that the industry is somehow preying upon the poorest of the poor who have no choice but to visit rental-purchase stores. "Most rent-to-own customers are not constrained to a neighborhood rent-to-own store by a lack of transportation and are able to comparison shop at traditional retail stores if they choose to do so."

Also important is the finding that 77 percent of rental-purchase customers have at least one type of credit card or a bank account. They are not part of the "unbanked" population in this country and this finding may help the industry separate itself from the alternate financial services sector that is so much criticized by consumer groups these days.

Initial reactions to the FTC report have been favorable both inside the industry and out. Rental dealers had copies with them during the most recent legislative conference in Washington last month and members of Congress and their aides seemed favorably impressed with the FTC's conclusions about the industry. In Florida, a rental dealer had been negotiating for lease space for a new store in a shopping center owned by Fannie Mae. The bureaucrats in charge of the property had insisted that they didn't want to lease to any rental-purchase tenants. When they were shown a copy of the FTC report, this objection went away and the dealer got the lease signed.

The industry does not realistically expect the White House, which commissioned the study, to promote the findings, but the industry can count on its friends in Congress to do so. The industry itself, through the national and state associations, has a rare public relations opportunity to spread good news about rental-purchase from an unbiased third party. APRO members can obtain copies of the FTC report from the APRO office or from the FTC Web site at www.FTC.gov/.