

What started as purely academic research on a relatively unstudied industry by two New England economic professors is slowly igniting a fire with the fuel to change perceptions on the widely misunderstood rent-to-own industry

BY STEPHEN SCHENCK

Academics, Wall Street

AND THE RENT-TO-OWN TRANSACTION



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ost recently, a small group of Wall Street analysts and Michael Anderson, an assistant professor of finance at the University of Massachusetts-Dartmouth, met in New York to discuss the rent-to-own industry on December 12, 2003. The meeting centered on academic research Anderson and Sanjiv Jaggia, a professor of economics at Boston's Suffolk University, have been conducting on the RTO transaction, including the results of two papers that have been published in *The Journal of Consumer Affairs* and *The Journal of Applied Business Research*.

"Periodically, analysts for research firms that follow the RTO industry for various institutional clients invite industry executives to talk about their company and their prospects," Anderson says. "They thought it would be interesting to hear a presentation from someone outside the industry this time."

The professors' research is particularly interesting because it largely contradicts previous studies, which have tended to view RTO contracts as "disguised installment agreements." Central to this debate is the question of whether RTO is used by customers as a means to purchase or rent household items.

Past studies, most notably the Federal Trade Commission report of 2000, relied on customer interviews and found that 60 percent to 70 percent of rental-purchase agreements resulted in the item being purchased. However, by examining transactional records over a two-year time period, Anderson and Jaggia found purchases comprise less than 40 percent.

"I was told my audience was mutual fund managers and analysts interested in getting additional insight into what is kind of an under-analyzed sector," Anderson says.

The Association of Progressive Rental Organizations believes the new research is not only valuable information, but also provides a powerful tool in the industry's public relations and lobbying efforts. "For the past 20 years, our opponents have cited many studies citing the high costs of RTO and the victimization of our customers," says APRO Public Affairs Director Richard May. "Now we have an independent economic analysis that reflects a different view of the industry and is available to anybody, whether it's an investor, judge or legislator."

"Michael's work," says Robert Strauss, a consumer and retail senior analyst with Independent Research Group, "brings additional visibility to a segment of retail that continues to be underserved." Strauss and Independent Research Group organized and hosted the meeting with Anderson in New York City.

WHY RTO?

Although much of the attention paid to these two studies has been recent, Anderson's plunge into rent-to-own data actually began several years ago when another professor suggested he look into the industry for future research. "It was actually very serendipitous," Anderson says about the beginning of his research. "Raymond Jackson, a colleague in the department, had this idea to look at the rent-to-own industry. He had read some literature and noticed that no prior researcher had put it into an economic framework."

Once the professors decided to focus their economic research on RTO, what they needed next was to acquire reliable data on which to base their study.

Anderson and Jackson contacted APRO, hoping the Association would be interested in providing some research funding. However, in order to avoid any impression of the research being industry-funded and keeping it independent, APRO put the professors in touch with High Touch, a company that provides RTO stores software to track transactions. "We were able to get a bunch of data, so what really started as a modest, little project, turned into a really major one," says Anderson.

Based in Wichita, KS, High Touch's Director of Sales John Rogers says that he was interested in the possibilities of Anderson's research when he first learned about the project four years ago. "Regardless of how the results turned out, I was excited to see that a university was looking at RTO. At that time, there had been no formal academic research into the industry."

After poring over data from 100 rental-purchase stores across the country covering a 10-year time period between 1991 and 2001, the professors decided to base

their research on 352,646 transactional records, 95 percent of which originated between 1998 and 2001. "There is so much information there that is so fascinating not just in terms of RTO, but economics in general," says Anderson. "There aren't many data sets that are this detailed about consumer behaviors, so there are many questions into which we can hopefully gain some insight."

OLD QUESTIONS, NEW ANSWERS

The result of Anderson's initial analysis of the data turned out to be quite surprising and would later form the basis for his paper, "A Reconsideration of Rent-to-Own," which was published in the winter 2001 issue of *The Journal of Consumer Affairs*. Although the paper confirmed some of the previous research by other entities, which had found the majority of RTO customers to be low income and female, it contradicted the negative view that RTO took advantage of its customers.

"One thing that was interesting was seeing how little work had been done on an important industry that

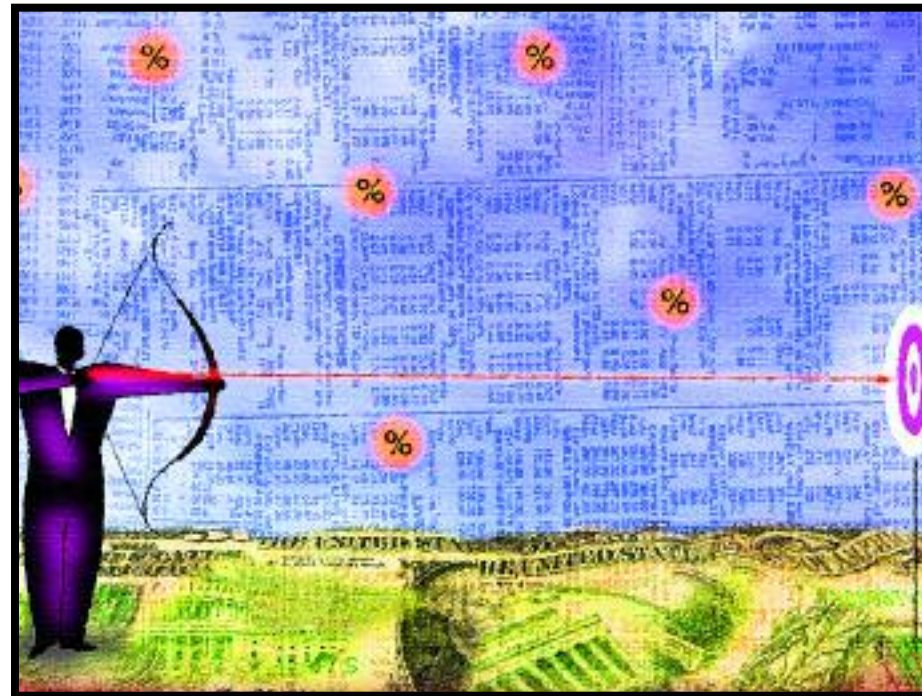
ous options outside the traditional methods of credit cards and layaway to obtain goods for their homes.

The article suggests that a straightforward casting of the rent-to-own agreement into a mold of an installment sales contract obscures the actual benefits and costs to the consumer and yields misleading public policy recommendations. In reality, a rent-to-own agreement offers consumers a series of valuable services and options unavailable in the installment purchase contract.

A RECONSIDERATION OF RENT-TO-OWN

So what could be the reason behind such significant differences in conclusions between Anderson's study and earlier research? The answer lay in whether RTO agreements were classified as rentals or purchases, which was also the topic of Anderson's second paper, "Rent-to-Own Agreements: Purchases or Rentals?" published in *The Journal of Applied Business Research*.

If most customers carried their RTO contracts to term, then they could be classified as purchases, as was the finding in the FTC telephone study, then the agree-



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offers what is really a unique arrangement," says Anderson. "What existing research that was out there was all particularly one-sided. It seemed that the only viewpoint that had been expressed was one that consumers were being exploited by these agreements. As far as we know, we published one of the first articles out there that said, wait a minute, there are other economic reasons why consumers would be interested in RTO."

The paper seemed to support what RTO owners had been saying for years, that RTO offered customers vari-

ments could be viewed as installment contracts, resulting in customers paying extremely high annual percentage rates. In his second paper, however, Anderson's research proved otherwise.

"Our main result, derived from an analysis of disposition and duration, is that RTO agreements are more frequently used for short-term needs rather than as a method of acquisition. Legislative and legal efforts to classify RTO agreements as primary installment contracts cannot be justified by their pattern of use in the

marketplace,” says Anderson.

The second paper was significant from an RTO perspective because it revealed how customer surveys, as helpful as they were in determining demographic information, were severely limited in other ways. Primarily, studies based upon customer interviews seemed to be unable to predict accurately whether items would be returned or rented to term and purchased.

“The FTC report is based on survey data and ours is based on transactional data,” says Sanjiv Jaggia. “They both have their own appeal in some ways, but there is no doubt, in any academic’s mind, that transactional data is more reliable. In a survey you ask somebody, ‘Are you going to return the item or purchase it?’ The person will say ‘yes’ or ‘no’ based on what they are feeling at the time, but we don’t know what that person will really do.”

This criticism of customer survey data, now that it has been accepted into reputable academic journals, could be helpful in lobbying for the RTO industry, says APRO’s Richard May. “The second study goes at certain lengths to question the validity of the conclusions of the FTC report, which we have had difficulty explaining on Capitol Hill,” says May. “Before we had the FTC report saying the RTO customers’ ownership ratio is 70 percent, which we have always questioned because that is just not how it is in this business.”

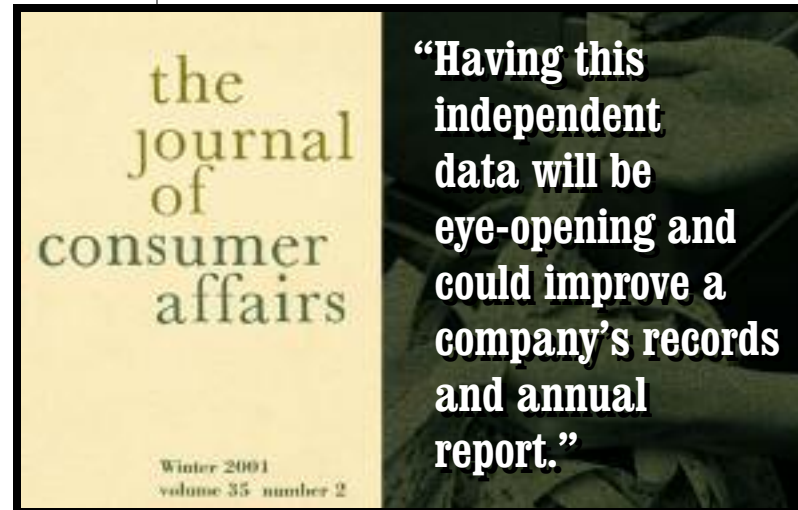
FUTURE RESEARCH AND ARTICLES

After the publication of the first two papers, detailing the work he did with Raymond Jackson, Anderson has continued his RTO industry research with Jaggia, who he met in graduate school at Indiana University. The pair has co-authored two more papers, which are currently in the peer review process, awaiting publication. “Rent-to-Own Agreements: Customer Characteristics and Contract Outcomes” and “A Multiple Destinations Analysis of Rent-to-Own Transactions” delve more deeply into statistical analysis and economic theory.

“Michael contacted me two-and-a-half years ago with a proposal to work on a few projects concerning rent-to-own,” says Jaggia. “I didn’t know much about the industry, but he told me about the data he had, which was really a fabulous data set. My specialization is statistics and econometrics, so we discussed some things and discovered we had many ideas that we could pursue,” he says.

Econometrics is the application of mathematical and statistical methods to economics.

“We are trying to explore these things with cutting-edge statistical methods and being as careful as we can to make transactional data more solid and reliable,” says Anderson. “At the same time, we’re trying to understand



some consumer behaviors, such as how does one pay [weekly or monthly] and how long the agreement is and how these factors contribute to the actual outcome of transactions.”

For their part, Anderson and Jaggia believe the future of their research into the economics of the rent-to-own industry and its transaction is very bright. Both expect their partnership to continue to grow and additional papers could be inevitable.

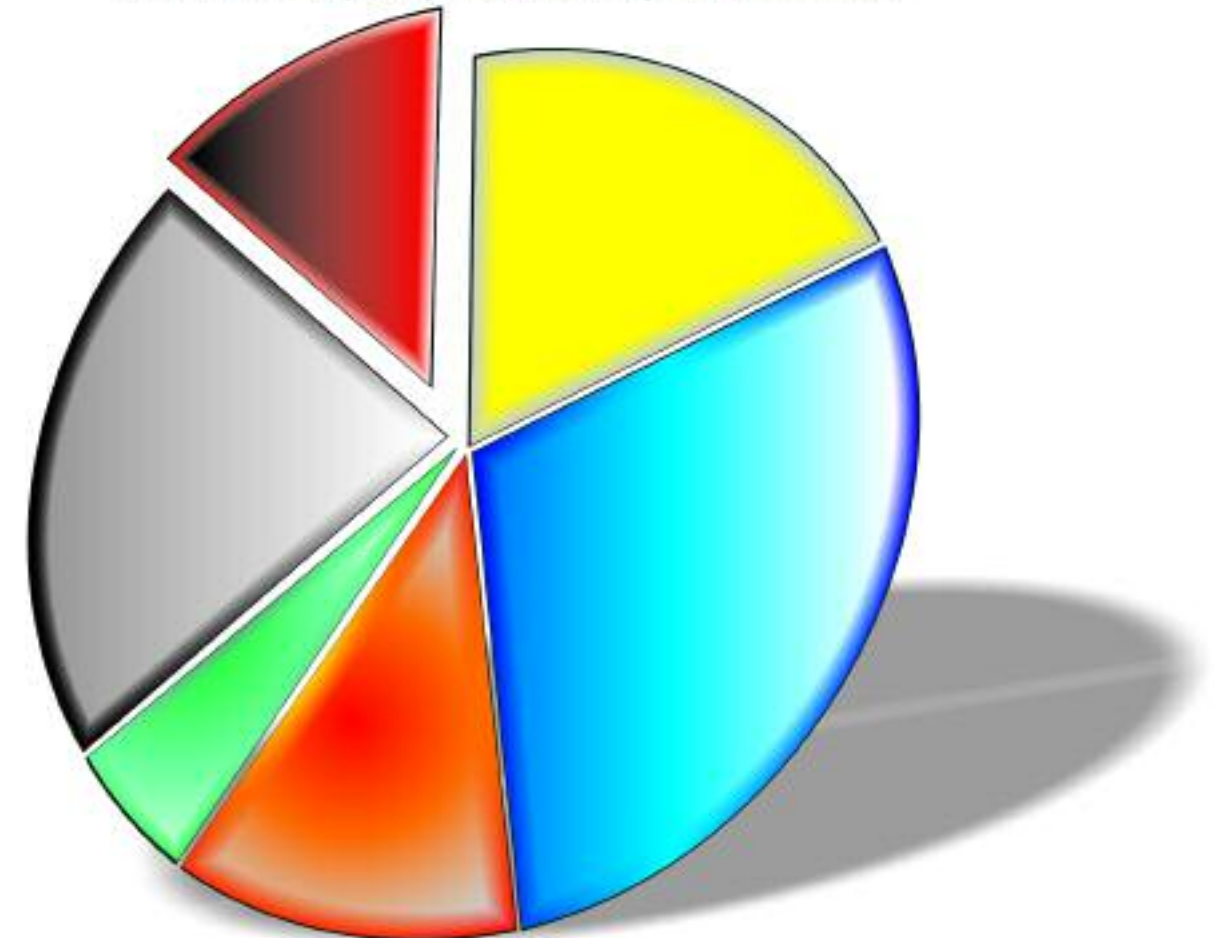
High Touch’s Rogers is also looking forward to future research by the professors because he thinks the more detailed data will provide a deeper analysis of the RTO transaction, which will be invaluable to RTO store owners. “I don’t believe that most dealers manage their business using industry benchmark data,” he says. “Though the industry has done well regardless, having this independent data will be eye-opening and could improve a company’s records and annual report.”

“We are very optimistic about this research because it also gives insight into areas outside of the rental-purchase industry,” says Jaggia. “For example, we are finding that whether it is a weekly or a monthly rental has a big impact on whether the item will be returned or not and there should be absolutely no reason in pure economic terms why that should make a difference. This, I think, should have interest for any economist, not just one studying rent-to-own stores.”

To download a copy of “A Reconsideration of Rent-to-Own” or “Rent-to-Own Agreements: Purchases or Rentals?” go to www.APROvision.org/legalchannel.html.

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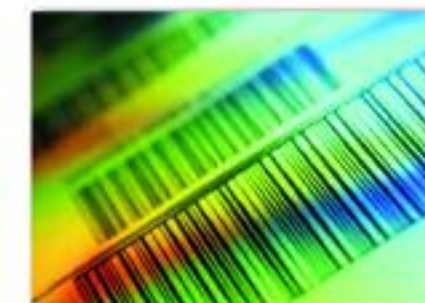
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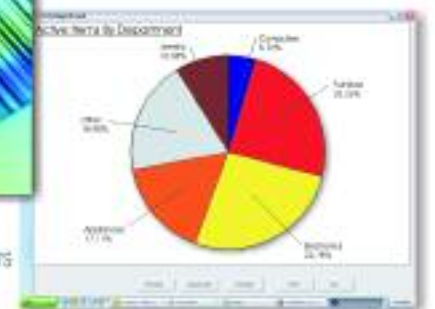
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