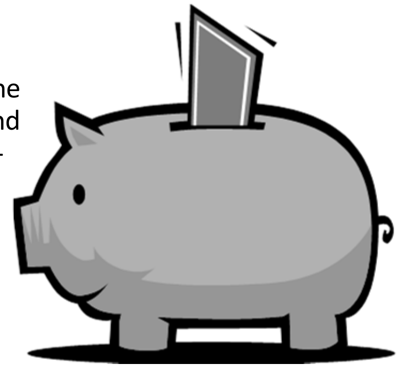
Mainstream vs Alternative Financial Services

POWERPOINT PRESENTATION
Today, you will create a 4-slide PowerPoint presentation summarizing the differences between Mainstream Financial Services (offered by banks) and Alternative Financial Services (check cashing outlets, payday loans, rent-to-own). Use the information shown below to help you in preparing your PowerPoint. Be sure to make your PowerPoint interesting by using fonts, colors, backgrounds, clipart, wordart, animations, etc.

You will have the option of presenting your PowerPoints in class!



MAINSTREAM FINANCIAL SERVICES

Mainstream financial institutions include commercial banks, savings and loan associations, credit unions, consumer credit companies, and so forth. For many families, it is advantageous to use such institutions. For example, banks offer many advantages over the check-cashing outlets and providers of payday loans. Most importantly, banks offer a safe place to keep money. The federal government insures deposits in banks. In contrast, holding cash savings at home is very risky. Cash can be easily lost or stolen. Banks and similar institutions offer several other advantages as well. They enable bank customers to accumulate savings, develop a credit history, keep records, and use various financial services at comparatively low rates.

In the past, each type of financial institution offered specific services. Banks took in deposits for savings accounts, checking accounts, and certificates of deposit. Banks then made loans to individuals and businesses. Savings and loan associations offered savings accounts and home mortgages. Credit unions were member-owned cooperatives that made low-interest loans to members. Brokerage firms were businesses that bought and sold stocks and bonds. Today the lines between all these institutions are blurred. For example, commercial banks can now sell stocks and bonds. Savings and loan associations can offer many types of loans in addition to home mortgages. And everybody, it seems, offers credit cards. There is a lot of competition among various sorts of financial institutions today.

Deposit and Saving Services: checking accounts, savings accounts, CDs, ATMs, debit cards, direct deposit and automatic withdrawals, safe-deposit boxes.

Credit Services: credit cards, installment loans, mortgage loans, home equity loans, student loans, small business loans.

ALTERNATIVE FINANCIAL SERVICES

Check-Cashing Outlets
At check-cashing outlets, customers pay a fee to cash their checks. That raises one problem. Keeping cash can be very risky. Cash can be easily lost, stolen, or spent. And most people don’t keep records of cash transactions. Cashing checks at check-cashing outlets does not allow individuals to establish a financial history. As a result, when it comes time to seek a financial service from a mainstream bank—getting a car loan, for example—there is no financial history for the bank officials to use in making decisions about an individual’s creditworthiness.

Payday Loans
Payday loans are small loans made by a short-term lender to individuals—usually for $150 to $300. Most customers write a postdated check and leave the check with the loan provider for an agreed-upon amount of time—usually two weeks or until the next payday. When the time period is up, the loan provider cashes the check unless the customer reclaims the check and repays the loan. Title loans are small loans provided by short-term lenders, often for 30-day periods. In the case of title loans, the equity value of a car is used as collateral. The applicant must own the car free and clear. Failure to repay the loan, or to make the agreed-upon interest payments to extend the loan, means that the lender can take possession of the car.

Some customers find it advantageous to use payday loans and title loans. The key advantage is that such loans may be helpful to people facing a sort-term financial emergency—an unexpected moving expense, a medical expense, a car repair bill, and so forth. While banks often do not offer loans for less than $1,000, short-term lenders do. Also, payday loans are easy to obtain. They do not involve a credit check, and loan transactions are often completed within 10 minutes. Finally, the loans are confidential. People who use payday or title loans do not need to approach an employer or a family member to ask for help.

There are several disadvantages to payday loans and title loans. These loans are usually very expensive. There are two ways to look at the expense involved. Suppose the fee for a two-week, $100 loan is $33. If you convert that fee to an annual percentage rate, it comes to 858 percent. That is a terribly high rate. But it may be misleading to use an annual percentage rate in thinking about how expensive a two-week loan is, so let's look at the cost in another way. The main disadvantage of payday loans is that many people do not pay them back on time. If a person is a little short of cash before the end of one pay period, it is easy to imagine that he or she will be short of cash during the next pay period. When the borrower cannot pay off the loan, the loan is renewed or "rolled over." This means taking out another loan to pay off the first loan. Or the loan agreement may specify that an interest payment will be required to extend the first loan if it is not paid off on time. Either way, it's expensive. Imagine that a person takes out a payday loan for $200 for two weeks at a fee of $40.00. If this loan is refinanced four times, the cost increases dramatically. In fact, in the course of four renewals, the borrower will wind up paying about $200 to borrow $200 for 10 weeks.

Rent-To-Own

Rent-to-own stores rent and sell many products including appliances, furniture, television sets, and CD systems. Ordinarily a customer agrees to rent a product for a period of time, perhaps one week or one month. If the customer rents the product for a specified period of time— commonly 18 months—he or she will become the owner of the product.

The key advantage of rent-to-own arrangements is they provide immediate use of a product for people who may lack cash and find it difficult to obtain credit from other sources. The rent-to-own transaction is usually convenient and fast. There are no credit checks, and the agreement can be easily canceled.

The main disadvantage of buying goods from a rent-to-own store is the cost. Ordinarily, it costs two to five times more to purchase a product from a rent-to-own store than it would cost to buy the same product from an ordinary store. If the difference between the total payments and the price of the product at a conventional department store were expressed as an interest rate, the rate would commonly be over 100 percent, and at times it reaches more than 300 percent. And besides the payments and tax, rent-to-own agreements may involve other fees, including the following:

- Service fees
- Delivery fees
- Installation fees
- Sales tax
- Home pick-up fees
- Reinstatement fees (charged if a payment is late or missed and the customer wants to continue renting)

Even for people operating on a tight budget, there are alternatives to rent-to-own arrangements. One is to save up the money needed to pay the full purchase price, or a down payment on a layaway or installment plan, at a conventional store. People who manage to do this will pay much less than the costs involved in rent-to-own arrangements. Garage sales, auctions, second-hand stores, and the classified ads in the newspapers also may provide money-saving alternatives.