

# The role of pawnshops in the loan market: Ukrainian and foreign experience

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**Abstract** - In this paper the current state of pawnshops activity in the Ukrainian loan market is analyzed. This paper defines advantages and disadvantages of pawnshop loans compared to other short-term loans, and provides a comparative analysis of the pawnshop industries in Ukraine, Sweden and the USA.

Key words – pawnshop, secured loan, consumer credit, microcredit, short-term loan, mortgage assets, pawnbroking services

## I. Introduction

A developed credit market involves the work of many financial institutions that perform specific functions, compete with each other and thereby increase the efficiency of its operation. Decisive role in the credit market belongs to commercial banks, but recently the importance of other specialized non-bank financial institutions started growing. Among such institutions, one can distinguish pawnshops, which have become an active source of consumer credits.

## II. Main part

Pawnshop (Lombard) is a financial institution, the sole business of which is to provide financial loans to individuals at its own risk at the expense of its own or outside funds secured by the property for a specified period and at the interest and provision of the related services by the pawnshop (valuation of mortgage assets, sale of mortgage assets, insurance of mortgage assets as an insurance agent). Pawnshops are among the oldest financial institutions. Researchers recognize that the market of pawnbroking services in Ukraine is the least regulated sector of the credit market [4].

Pawnshops work exclusively with individuals and have the right to a rather limited range of operations in Ukraine. However, the market of pawnshop loans in Ukraine shows a steady increase (Table I).

TABLE I

PAWNBROKING IN UKRAINE  
YEARS 2009- THIRD QUARTER 2012 [1, 2]

|                                 | 2009  | 2010   | 2011  | Q3/2012 |
|---------------------------------|-------|--------|-------|---------|
| Number of pawnshops             | 373   | 426    | 456   | 466     |
| Amount of credit, UAH millions  | 3505  | 5503,1 | 7325  | 6538,7  |
| Growth rates, %                 | -     | 57     | 33,1  | -10,7   |
| Average annual interest rate, % | 251,1 | 216,5  | 214,5 | 196,4   |

In the period from 2009 until the third quarter of 2012, the number of subjects in the market of pawnshop loans has only increased and as of 30.09.2012 the State Register of financial institutions included information about 466 pawnshops [1]. Increased number of pawnshops indicates attractiveness of this market in terms of entrepreneurship and a steady demand for microcredits among population.

Within the Ukrainian financial sector, a share of the whole non-bank segment is unreasonably small, and at the beginning of 2012, it did not exceed 7% of the overall volume of assets of financial institutions. The share of pawnshops assets is only 1.5% in the total assets of non-bank credit market segment [1,2]. Obviously, the pawnshops cannot play decisive role in the loan market especially compared to activity of bank system. However, pawnshops show a high activity among non-banking financial companies and following the results of the first 9 months of 2012 pawnshops have increased the volume of financial loans by 30.8% compared to the same period in 2011 [1].

Pawnshops have occupied a special niche in the financial and credit markets, i.e. short-term consumer loans for population. This suggests that pawnshops are not direct competitors for such credit institutions as banks or credit unions, but serve an alternative solution for people who have an urgent need for cash, and for unbanked and underbanked households.

The main advantage of a loan in a pawnshop is that it is granted immediately. Execution of a loan agreement upon the security of precious articles or household appliances takes a few minutes. Among other advantages of a pawnshop loans as compared to other short-term loans are the following: no need to provide an income certificate, convenient form of collateral, the possibility of early repayment of the loan amount without financial loss, the possibility to reject loan repayment by waiver of the subject to mortgage.

However, the loans obtained from the pawnshop are much more expensive than the bank loans. During recent years the average weighted annual interest rate on financial mortgage credits has been decreasing, and regarding the results of the first three quarters of 2012 amounted to 196,4%. For the same period annual percentage rates on credit extended to households by banks was 25,6% [6]. So, pawnshop loan is about 7,7 times more expensive than a bank credit.

One cannot provide an unambiguous estimate to the role of pawnshops in the loan market of Ukraine. The very fact of a pawnshop loan means that the money received from such loans is used to meet basic human or emergency needs. It does not make sense to give the property upon the security to purchase some other property. However, if we consider that, based on the results of the first three quarters of the year 2012, the amount of repaid financial credits constituted 97.45 % of the amount of granted financial loans, where only 8.32 % of credits were repaid at the expense of the collateral, one may state that pawnshops are not consignment stores or outlets for stolen goods, but remain an important source of micro crediting for population [2].

Consequently, too rapid development of pawnshop crediting is a negative phenomenon in terms of socio-

economic development of Ukraine, a peculiar signal of reduction of citizens paying capacity and worsening of banking system efficiency.

Lombard institutions exist throughout the world, and especially prevail in the countries with the developed economy and high standards of living, including such countries as the USA, the UK and Sweden (Table II).

TABLE 2  
PAWNBROKING IN UKRAINE, SWEDEN  
AND THE UNITED STATES [5]

|                                  | Ukraine           | USA     | Sweden |
|----------------------------------|-------------------|---------|--------|
| Average loan size, US\$          | 90,1 <sup>1</sup> | 150     | 354    |
| Average monthly interest rate, % | 16,4 <sup>2</sup> | 15      | 3,5    |
| Most popular pledge              | gold              | gold    | gold   |
| Number of pawnshops              | 456               | > 10000 | 56     |

Notes: 1. Exchange rate September 2013, UAH 1 ~ 0.125 USD  
2. In the first three quarters of 2012

As one can see from the table, pawnshop services markets of Ukraine and the United States and Sweden have both common and distinctive features. In all countries, pawnshops offer short-term consumer loans and the most popular type of mortgage is goldware. The main distinguishing feature of the collateral loans is the amount and credit price. The average monthly interest rate on loans in Ukraine is the largest one and constitutes 16.4%, while the average loan amount is the smallest one – 90.1 US dollars (as compared with \$ 150 in the US and 354 dollars in Sweden).

The average value of collateral loan in Ukraine tends to the minimum salary (Figure 1) and in the period of 2010-Q3/2012 amounted to 66.7-80.23% of the minimum salary rate. In the US, the correlation of midsize pawnshop loan to the minimum salary in 2012 is 12.5%. [7].

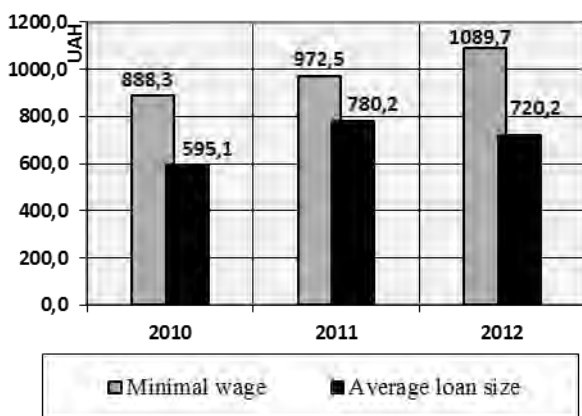


Fig 1. Minimal wage and an average pawn loan size in Ukraine. Years 2010-third quarter 2012

Thus, we should consider Ukrainian and American markets from different angles. Ukrainian pawnshops are an important source of consumer credits for the low-income households, while in the US collateral loans are used because of some urgent financial problems.

## Conclusion

The results of the research have demonstrated that the value of pawnshops in the loan market of Ukraine is underestimated. Collateral credits volumes as an independent sphere of financial relationships are growing rapidly, despite small share of the pawnshops assets in the total assets of non-banking sector.

Lombard institutions are social and economic stabilizers in the event of any fluctuations in the economy. However, thought too rapid development of the collateral market is a positive trend, it carries a tinge of negativity. The state, as a regulator of financial relations in Ukraine, in this situation should: focus its efforts on development of other forms of consumer credits, among other things through banking and non-banking institutions; take a series of measures to increase the availability of consumer loans (e.g., introduce ceiling interest rate on financial loans as in the USA), and ensure harmonization of collateralized property valuation rules.

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