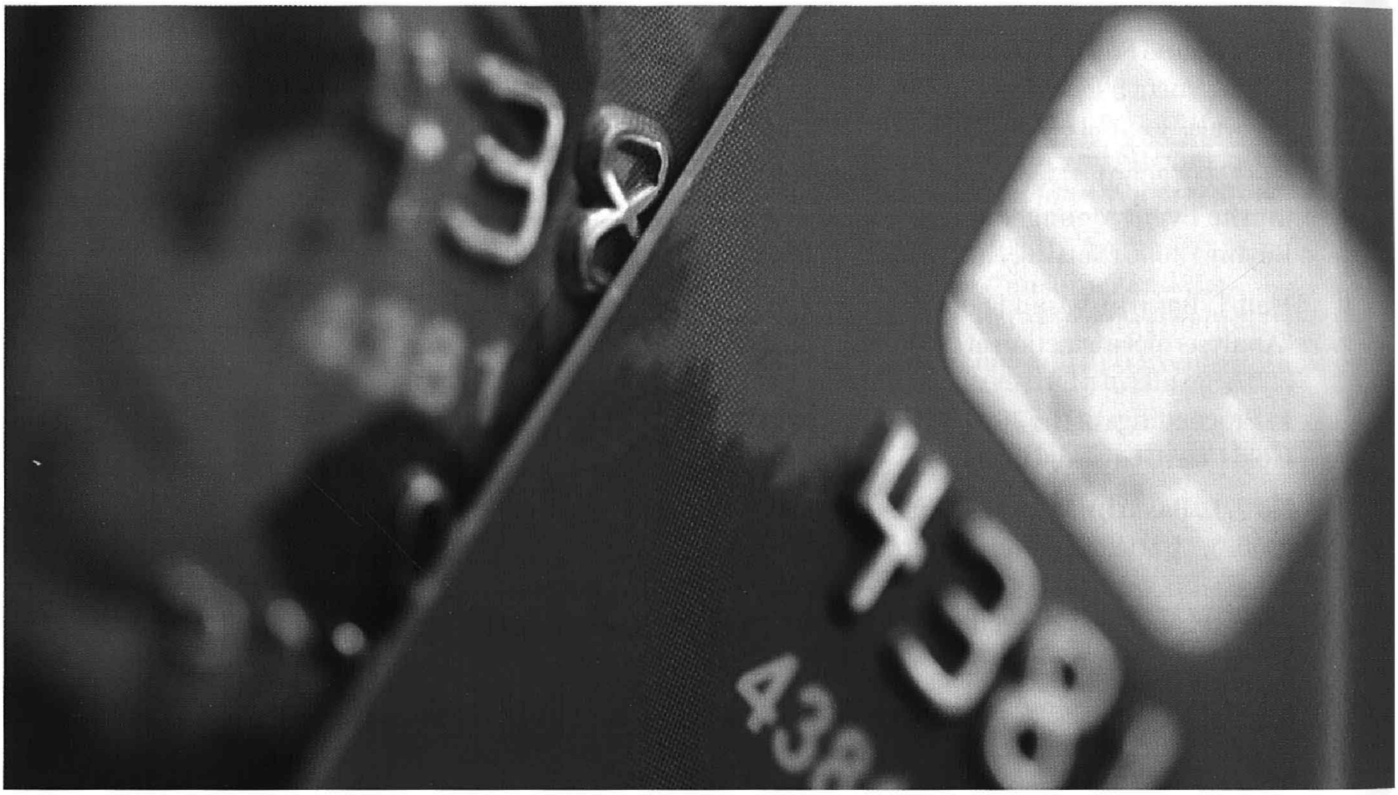
The ethics of credit limit increases

Paul Harrison



The past few decades of psychological study and consumer research have witnessed a shift away from the view that choice is the product of a rational, logical decision-making process. The current view is of the individual as a user of heuristics and shortcuts: one who makes judgments and decisions based on scant data, which are haphazardly combined and influenced by preconceptions and expectations. Marketers know this, and exploit the willingness of consumers to use shortcuts when making decisions. In one particular context, however, this exploitation can have serious consequences.

The exploitation of credit card users in particular has become pertinent as a result of the recent global credit crisis. In Australia, for example, there is currently $44.6 billion worth of outstanding debt on credit cards, with more than $30 billion (over 70 per cent) bearing interest. In 2001, Visa reported that 32 per cent of consumers had not paid off their card in the previous 12 months. This suggests that interest-bearing debt in Australia is held by approximately one-third of credit card borrowers.

The requirement of credit card resellers – such as banks and finance groups – to sell credit as part of their core business, has resulted in a range of marketing methods to encourage consumers to take up more debt. One of these approaches is the use of unsolicited credit limit increase offers (the finance industry refers to these as CLIs). Banks use CLIs because they know that they work, and while there are no figures available that identify the percentage of outstanding credit card debt that results from CLIs, a 2001 industry report gives some indication. The report, published by Visa, says that if there was a ban on pre-approved increases, "consumption expenditure in the Australian economy could be reduced by around $30 billion per annum."

EVIDENCE FROM INTERNATIONAL STUDIES SUGGESTS THAT THESE OFFERS ARE TARGETED AT CUSTOMERS WHO ARE ALREADY AT THE UPPER END OF THEIR CREDIT LIMIT, AND ARE UNLIKELY TO PAY OFF THEIR DEBT EACH MONTH.

A CLI is a letter, pamphlet or document that offers current cardholders an increase on their credit limit (e.g., from $2500 to $4000), in circumstances where the cardholder has not sought, or enquired about, an increase. In many cases, these offers claim to be 'pre-approved', and there is little or no requirement for the provision of information by the cardholder prior to the increase being granted. Evidence from international studies suggests that these offers are targeted at customers who are already at the upper end of their credit limit, and are unlikely to pay off their debt each month.

From a marketing perspective, the CLI is both a sales tool and a promotional tool, and is what marketers refer to as a 'call to action'. Contrary to arguments put forward by industry associations, however, the CLI letter is more than a means of communicating information; it reduces the potential level of engagement with the decision to take on more debt. This is because it requires little cognitive effort beyond a decision to agree or disagree with the offer. In contrast, the process for completing a credit card application requires the consumer to participate in a range of cognitive and physical activities. These include the provision of personal details, such as name, address, phone number and date of birth; the process of calculation of income and expenditure; and the collation and verification of materials such as pay slips and forms of identification.

A range of psychological factors combine to make the CLI an effective way to sell debt to particular target markets. These include well-established psychological manipulations, such as trust in brands (which increases our willingness to take risks); authority (the letters are perceived to be signed by important people in the organisation, which again increases our willingness to take risks); the use of endowment (we take psychological ownership of something as soon as it is given to us); establishment of a status quo (the increased limit is now 'our' money); and scarcity (act now, or we will miss out – which increases the perceived value of the offer). All of these factors are part of the marketer's bag of tricks. These manipulations, combined with the normalisation of credit as a means of transacting in the marketplace, make it easy for vulnerable consumers to accept these offers.

And don't be fooled into thinking that banks – which in recent times have represented themselves as ethical and socially responsible organisations – are not willing participants in this activity. Put simply, banks are profit-making corporations, and they know exactly what they are doing when it comes to the use of CLIs. As one bank's CEO commented to Sydney radio host Bill Crews recently, "...we're not a welfare agency."

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Indeed, in the context of a profit-making corporation, it is questionable whether being socially responsible is possible. Nobel Prize-winning economist, the late Milton Friedman – whose work has informed much of our libertarian and rationalist economic framework over the past 30 years – argued that it is a contradiction for a corporation to behave in a responsible way. He states that: "Only people can have responsibilities, but business as a whole cannot be said to have 'responsibilities' in that they are artificial persons."

Friedman points out that there is a conflict of interest between corporations and society, which makes it very difficult for businesses to be socially responsible. He states that: "A member of a corporation should never act against the interests of the corporation and of his employers." In other words, corporations should obviously act within the law, but should always further the corporation's interests, over and above the interests of the citizenry.

I recognise that this may be perceived as a particularly jaundiced assessment, but there should be no doubt that a corporation will act, first and foremost, in its own interests. To put it another way, it is unlikely that a bank will make a decision purely on social grounds, without also considering the economic implications. However, it is highly unlikely that a bank will make a socially responsible decision that has no (long- or short-term) business benefit. This is a reasonable approach for a business. To behave otherwise would be in breach of its commitment to shareholders.

Of course, businesses, including banks, are attempting to behave in a more socially responsible way, some better than others. The main issue to accept, though, is that banks do 'marketing', and they have every right, and are required, to do so.

In light of this, however, there are some important factors to consider. Banks and finance corporations are massively well-resourced organisations, with access to the latest research about the market and human behaviour. They are able to act (mostly) rationally; are generally aware of what they are doing; and are in the business of selling products. In other words, they know which 'buttons' to push, to get different customer segments to purchase their products. To deny this, would be to admit that all forms of marketing are pointless.

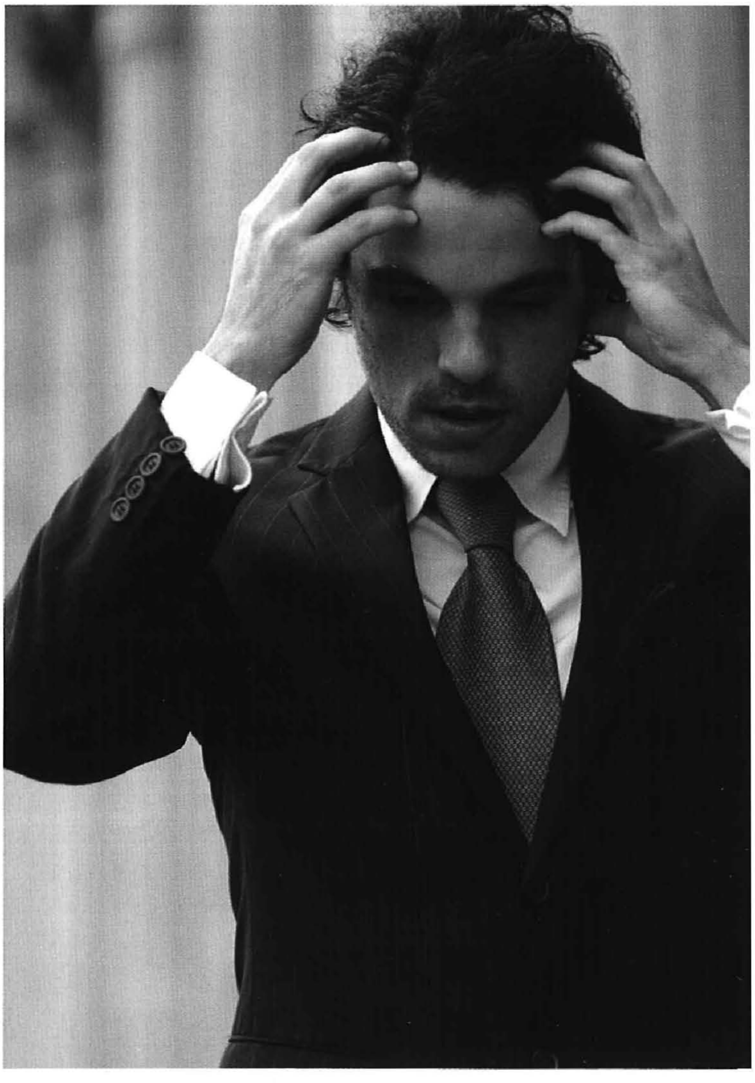
In contrast, consumers are individuals who are overwhelmed with psychological and social pressures; use shortcuts based on trust, inertia and loyalty; and are rarely able to make clear, rational, unbiased judgments.

Consumer regulation, however, relies on a belief in a rational consumer: one who considers the pros and cons of a particular choice, and after weighing up their options, chooses the product that provides the most utility. Consumer regulation implies, through its focus on the improvement of information disclosure, that for the most part, this is a process carried out in the conscious mind. The notion that increased disclosure will alleviate any issues around psychological manipulation can be argued to be somewhat erroneous if we accept that consumers will invariably use shortcuts and heuristics in decision making, particularly when they face large amounts of unfamiliar information.

Of course, people should take responsibility for their actions. Put simply, though, it is not a level playing field. It is naïve to think that a decision is not influenced by a whole range of other factors, which may be out of the awareness, or control, of the individual. The people who take up these offers are responding, as best they can, to the complicated environment in which they live. Marketers know this, and they exploit this, and they get away with it – because it is easier to blame an individual than the abstract notion of the banking sector, or more broadly, the market. No one wants to admit that we are flawed decision makers. But we are – we make poorly judged decisions every day. Most of the time we get away with it, and don't often notice it, because the consequences aren't too serious. But in some situations, such as getting ourselves further into debt, the consequences are dramatic, and sometimes tragic.

The Australian Bankers' Association asserts that the low levels of default on credit card debt suggest that there isn't a problem with CLIs (and credit marketing in general) and therefore any further regulation of the sector is not required. However, it is not the default levels that are of concern in this context, but the amount of outstanding debt in the economy.

In looking at how to deal with this issue, recent discussions at the Council of Australian Governments' meeting, as well as the Labor Party commitment to addressing this issue at a national level, provides hope that policy makers finally recognise that people aren't as rational as the economic models would have us believe. As the Federal Government takes on the responsibility for dealing with credit cards and pre-approved credit, it will need to consider regulation that does not rely solely on providing more information to consumers – or more information about consumers to banks – but considers how the market and marketers really behave. DBR



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