



DISCUSSION PAPER

PAYMENT CARDS CENTER

Voting With Your Feet: Consumers' Problems With Credit Cards and Exit Behaviors*

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***Summary:** On December 17, 2002 the Payment Cards Center of the Federal Reserve Bank of Philadelphia hosted a workshop led by Jeanne Hogarth and Marianne Hilgert of the Consumer and Community Affairs Department of the Board of Governors of the Federal Reserve System. The presentation and subsequent discussion focused on their paper "Voting With Your Feet: Consumers' Problems with Credit Cards and Exit Behaviors," that was co-authored with Jane Kolodinsky of the University of Vermont and Jinkook Lee of the The Ohio State University. The paper is the result of a study conducted through the Surveys of Consumers which examined attempts by consumers to resolve credit card disputes and the subsequent effect on their relationships with the card's issuer. This short discussion paper summarizes key elements of the paper that were presented at the workshop.*

*The views expressed here are not necessarily those of this Reserve Bank or of the Federal Reserve System.

INTRODUCTION

On Tuesday, December 17, 2002 the Payment Cards Center of the Federal Reserve Bank of Philadelphia sponsored a workshop led by Jeanne Hogarth and Marianne Hilgert of the Consumer and Community Affairs Division of the Board of Governors of the Federal Reserve System. The presentation and subsequent discussion focused on their paper “Voting With Your Feet: Consumers’ Problems with Credit Cards and Exit Behaviors” co-authored with Jane Kolodinsky of the University of Vermont. Additional research presented at the workshop included work co-authored with Jinkook Lee from The Ohio State University.¹ Using data from the University of Michigan’s Surveys of Consumers, the studies examined consumer complaining behaviors regarding credit card disputes and the subsequent effect on their relationship with the card-issuing financial institution. Hogarth and Hilgert provided background on the motivation for the study, detailed data from the study, discussed their general results, and concluded with recommendations for the industry and consumers based on their results. The full paper can be found at: <http://www.consumerinterests.org/public/articles/VotingFeet-02.pdf>.

PROJECT MOTIVATION

Hogarth noted that credit cards are the number one topic of consumers’ complaints received by federal financial regulators. In their research, Hogarth and Hilgert attempt to explain what it is about this extremely convenient and increasingly ubiquitous payment instrument that results in so many complaints. They note that the sheer volume of cards is one obvious reason. Current data suggest that more than 75 percent of the adult population in the United States has a credit card, and consumers’ outstanding revolving credit is over \$700 billion. In a recent study conducted by the Board of Governors, it was estimated that credit cards accounted for 21 percent of noncash retail payments in 2000, versus an estimated 10.4 percent in 1995.² Clearly, credit card use has grown rapidly and substantially in recent years. It is also possible that the increased complexity of credit card pricing schemes has led to consumer confusion.³ Finally, many new and

inexperienced users of credit cards have entered the market as issuers broadened their marketing efforts to target consumers with lower credit ratings (i.e., the subprime market). Given the high level of credit card use, the introduction of increasingly complex pricing practices, and the addition of new and inexperienced users, it is perhaps not surprising that the level of consumer complaints is high.

Although it may not be surprising to observe a high level of complaints among users of credit cards, it is not clear how this behavior affects subsequent actions, particularly “exit” actions. For the purpose of this study, “exit” is defined as either the actual termination of the consumer’s relationship with the issuer by closing the account or simply no longer using the card. Despite the extensive research in consumer complaining behaviors, there has been little effort to understand exit behavior, a category of complaining behavior. Importantly for this analysis, the balance transfer programs that are actively marketed by credit card companies provide dissatisfied card users with relatively easy switching options. Switching can be seen as an “exit strategy” and one that is more readily available in the credit card market than is generally seen in other financial service areas. Furthermore, most consumers hold more than one credit card, giving them another “exit-option,” that of simply not using the offending card. Given this scenario, the credit card market presents a unique opportunity to explore complaining behaviors in general and exit decisions in particular.

Hogarth noted that previous research on exit behavior suggests that the probability of exit is strongly linked to monetary influences and the level of dissatisfaction with the problem. In the credit card industry, Hogarth finds that the likelihood of exit can also be influenced by the card-use characteristics of the consumer. Revolvers (people who carry a balance on their card) may take advantage of balance transfer offers to switch to a new lender, or they may simply stop using the card and work on paying the balance. Costs may matter. Cardholders with low interest rates may not want to exit when the alternative is a high-interest-rate card, and, conversely, those with high-interest cards may be more willing to exit. The nature of the problem can also play a factor

in exit behavior. For example, if consumers' problems are a billing errors that need to be resolved, they will probably not exit until the error is corrected. However, they may stop using the card in the interim. On the other hand, if the problem is a customer service issue without monetary concern, the consumer can opt to switch to another card and close the original account.

PROJECT DATA

To study credit card complaining behaviors, Hogarth, Hilgert, and their colleagues used the University of Michigan's Surveys of Consumers. The Surveys of Consumers were initiated in the late 1940s by the Survey Research Center at the University of Michigan. The purpose of these surveys is to measure changes in consumer attitudes and expectations with regard to consumer financial decisions. Each monthly telephone survey of 500 households includes a set of core questions covering consumer attitudes and expectations.

From October through December 2000, the Federal Reserve Board included specific questions on credit card use and complaining behaviors; the resulting data set included 1,500 respondents. These tailored questions asked consumers holding various types of cards, including secured, bank, travel and entertainment, and store-based credit cards, about their satisfaction with their cards and problems they had with them.

A series of questions on the most recent problem experienced by the consumer followed the general usage questions. These questions included details on:

- ◆ the nature of the problem;
- ◆ the amount of money involved with the problem;
- ◆ the actions taken by the consumer to solve the problem;
- ◆ the order in which these actions were taken;
- ◆ whether the problem was solved and how;
- ◆ the amount of time invested in solving the problem;

- ◆ the satisfaction with the outcome.

Also, consumers who had stopped pursuing a problem were asked the reasons for terminating the process. Finally, the survey included a series of questions about the consumers' preferences for ways to lodge a complaint (i.e., over the phone, e-mail, or in person) as well as their overall knowledge and attitudes about credit cards and financial institutions.

RESULTS OF STUDY

Nearly one out of six households surveyed indicated that it had had a credit card problem in the past year. Only 4 percent of those who had a problem reported doing nothing to resolve the issue. According to Hogarth, this, in part, may reflect consumers' relatively high levels of expressed dissatisfaction (the median level of dissatisfaction was seven on a zero to 10 scale, with 10 being "absolutely furious"). At the same time, it is relatively easy to complain about credit cards. For example, the Fair Credit Billing Act allows a consumer to withhold the amount of money involved in a dispute until the dispute is resolved, so there is little monetary cost to initiate the complaint process. The industry itself provides easy access to customer service representatives through 800- numbers and instructions included in their monthly billing statements.

Of perhaps more interest, the study also revealed high exit rates for consumers who had a problem with a credit card in the past year; more than half (55 percent) of these respondents indicated they had stopped using their card or ended their relationship with the card's issuer. Exit rates were associated with the way in which consumers dealt with their complaints. All consumers (100 percent) who had involved a third party in the complaint process (i.e., a lawyer, a Better Business Bureau, or a federal, state, or local agency) exited; 83 percent of consumers who had taken private action (i.e., complaining to a friend or family member) exited; and 50 percent of

consumers who complained to the issuer exited. According to Hogarth, and as mentioned previously, these high exit rates may reflect the highly competitive credit card market in which consumers have relatively easy exit options.

Not surprisingly, exit rates were higher among those who were unable to resolve their problem. Two-thirds of respondents who were unable to resolve their problem exited. Perhaps more surprising was the fact that nearly half of those who indicated they had resolved their problem also exited.

The authors developed an econometric model to further analyze problem resolution and exit behaviors. One of the key findings of the statistical analysis was the effect of problem resolution on the predicted probability of exit. Consumers who were predicted to have their problems resolved were less likely to exit. Moreover, level of dissatisfaction was also found to be a statistically significant determinant of the probability of exit. As might be expected, the more dissatisfied a consumer is, the higher the likelihood of exit, irrespective of problem resolution. Nevertheless, on a relative basis the analysis suggests that problem resolution has a smaller effect on exit behaviors at both the high and the low end of dissatisfaction measurement. That is, for those consumers who were either not dissatisfied or extremely dissatisfied, resolution of the problem had less impact on the likelihood of exit.

CONCLUSIONS AND RECOMMENDATIONS

Despite the fact that credit card problems represent the most frequent complaints received by federal agencies, the good news is that the level of problems with credit cards is relatively low. The popularity of credit cards and their increased usage over time clearly has led to more complaints. But in this study, of the 1,062 consumers who had credit cards, only 166 reported having problems during the past year.

However, unlike other studies of complaint behavior, this analysis revealed relatively higher levels of exit behavior. More than half (55 percent) of the 166 respondents who had a

problem closed their accounts or stopped using the offending card. It is likely that these high exit rates reflect the highly competitive nature of the credit card market in the U.S. and the relative ease of switching. At the same time, the analysis also highlights the importance of problem resolution in reducing the probability of exit. While it is not possible to eliminate exit behaviors through problem resolution, it clearly helps in a meaningful way. This supports the industry's observed investment in customer service capabilities and the time-tested motivating truth that it is less expensive to keep a customer than to find a new one.

For consumers, Hogarth advised them to identify the nature of the problem and focus their complaining efforts with the card issuers. The card issuer is the most effective place to achieve resolution, as indicated in the study's results. Of course, failing resolution, consumers in competitive markets can "vote with their feet."

ENDNOTES

- ¹ Hogarth, Jeanne M., Marianne A. Hilgert, Jane Kolodinsky, and Jinkook Lee. “Problems with Credit Cards: An Exploration of Consumer Complaining Behaviors,” *Journal of Consumer Satisfaction/Dissatisfaction and Complaining Behavior*, 2001, pp. 88-107.
- ² Gerdes, Geoffrey R., and Jack K. Walton. “The Use of Checks and Other Noncash Payment Instruments in the United States,” *Federal Reserve Bulletin* (August 2002), pp. 361-362. (available at http://www.federalreserve.gov/pubs/bulletin/2002/0802_2nd.pdf)
- ³ Furletti, Mark. “Credit Card Pricing Developments and Their Disclosure,” *Payment Cards Center Discussion Paper* (January 2003), p. 1. (available at <http://www.phil.frb.org/pcc/discussion/discussion0103.pdf>)