How to help consumers reduce interest payments across multiple credit card accounts

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Researchers from the Norwegian School of Economics and University of Chicago published a new paper in the *Journal of*

Marketing that examines credit card minimum payment requirements affect consumers' decisions about how much to pay towards each debt account.

Many Americans received COVID-related stimulus payments. With nearly $800 billion dollars in credit card debt outstanding in the US, many consumers say they plan to use these payments to repay debt. However, how best to do this is not straightforward. Most households with debt must choose not only how much to put towards debt repayment, but also which debts to repay. How does a common repayment nudge, the minimum required payment, affect the decision of how much to pay towards each card? The researchers find that minimum payments cause consumers to spread repayments more evenly across debt accounts, even after accounting for the minimum payments themselves. They call this the "dispersion effect of minimum payments."

While this pattern may seem harmless, it leads consumers to repay less to their highest interest rate debts and to pay more interest overall. In other words, consumers end up spending more than is necessary to repay their debts. While there likely are multiple causes for the dispersion effect, one key factor is that consumers tend to interpret minimum payment requirements as recommendations to pay more than the minimum amount.

Given that credit card minimum payment requirements are needed by credit card companies and regulators, one important question is whether we can help consumers improve their repayment choices. Hirshman and Sussman propose that, even in the presence of minimum payment requirements, the way that companies display information about interest rates to consumers can accentuate or minimize the dispersion effect. The study uses several experiments to show how different ways of displaying this information affect repayment decisions.

For example, one type of display mimics standard paper credit card statements where participants need to search for credit card account information. This version leads consumers to pay the most in interest costs. In contrast, another type of display that gives consumers default choices of the minimum payment, the total debt amount, or "other" amount substantially improved consumers' repayment strategies relative to the paper statement.

When using this version, people allocate more money to their highest interest rate debt and spread money less evenly across accounts. The research has implications for policy makers, consumer advocates, and firms working to improve consumer financial well-being. First, firms may have an opportunity to help consumers pay less interest by aggregating their credit card debt information. As Hirshman explains, "Our results suggest that consumers tend to focus on interest rates when making allocation decisions, but don't do so enough. One factor that contributes to this is the minimum payment, but we also provide evidence that making the interest information more readily available helps as well."

Second, the marketplace can provide fin-tech products to save consumers money. "For example," says Sussman, "consumers might save money by paying a company a single sum and then having the company allocate this lump sum towards debt repayment across multiple accounts. Because of the high interest rates on credit card debts, even paying the company a fee may reduce consumer costs." Some companies like Tally already provide versions of this service. Third, the study documents an additional cost to consumer financial well-being of having multiple debt accounts.

There has been a recent push to use both big data and surveys to map consumers' financial health. Because of the dispersion effect, the number of credit card debt accounts a consumer has and the extent to which they concentrate payments towards their highest interest debts may be useful metrics to add to these efforts. Finally, when policy makers consider credit card statement changes, this study suggests it is important to pre-test how consumers interpret the changes. The nudges policy makers use can affect consumer decision making in unintended ways. Doing so will allow policy makers to produce desired effects while heading off unanticipated consequences.

More information: Samuel D. Hirshman et al, EXPRESS: Minimum Payments Alter Debt Repayment Strategies across Multiple Cards, *Journal of Marketing* (2021). DOI: 10.1177/00222429211047237

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