Building Castles in Thin Air: Uncreditworthiness of Credit Cards

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Introduction

Some years back when I was working in the credit card division of a reputed MNC bank, it was tough selling credit cards. False promises (in our terminology it was "Kasme wade"), making customers run for documents, keeping proposals for hold, (bad) selling was the order of the day. Most of the customers either knew something or nothing about credit cards. People never knew how credit cycle works, what hidden charges could be there, or what the avenues for the company to make money are. The moment a credit card is sold to a person, the telephone number goes to other credit card companies, or to loans division, and then telephone calls start coming to you as if the only business you have is to take credit cards. If a person has not received his bill for a particular month, and he has not paid, he enters into the defaulter list of that bank. If on the same month he applies for any loan in that bank he will not get it or will be asked to pay a higher rate. If a credit card is lost, you had it. The loss will have to be borne till the time they do not lock the card. So the risk factor still remains and customers must bear the risk. Another common thing is part payment of bills. In case you pay a part of the bill only, you pay double interest the next month. In case of a dispute with a credit card company and you opt for a full and final settlement; you still stand to be a defaulter. You will get loans at higher rates or your further credit worthiness will be looked down upon. The biggest problem that the customers faced was mental trouble, and harassment and most of the credit card companies will not tell you that. It is all about hard selling. Just "Pushing" through sales.

Current Scenario

"The Good"

As of March 31, 2006, the total number of debit and credit cards issued in India was estimated to be around 47 million and 18 million respectively. Indians withdrew nearly US$ 50 billion using credit cards from ATMs in 2005. This includes US$ 26 billion through Visa credit cards alone. As on March 31, 2006, Visa saw a 36 per cent growth in the number of cards issued, making India the third biggest card market for Visa, after Japan and Korea. We have been growing in terms of credit card figures. In times of emergency consumers have a strong credit backing. Indians have swiped their cards to buy goods worth Rs 28,000 crores ($6.2 billion). The average spends by consumers on credit cards is Rs 24,000 per annum. That's not much. The challenge is to increase the average spends. And credit card companies are being helped along materialistic Indians. Says Nitin Gupta, vice-president and general manager (South Asia), MasterCard International: "Consumer spends through cards in India are growing at 20% a year." This is much higher than the GDP growth. Santanu Mukerjee, country manager (South Asia), Visa International.

"The Bad"

The "noveau riche" class pays interest rates to the tune of 25-30%,because they do not know how interest is charged. These sets of vulnerable people have no habit of saving. Decreasing credit card debt is never taught in any family today. The importance of savings is not made clear to children at an early age. They withdraw money from one credit card to pay the bills of another or loan that is running. Even for amounts like Rs 50000, they look in for personal loans. That is the apathy of their savings habit. Everything has become a show off. One is trying to show another about their lifestyles and that is where credit card companies cash on. Everything runs in credit for them. From the food they eat, (6 EMI's) to the clothes they wear. Everything is in credit. The credit keeps on mounting up.

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"The Ugly"

From my experience it was certain set of customers like DINKS (Double income no kids), people working in call centers, BPO's, people who have just started earning and made a mess out of these credit cards.
They form the safe easy bet of the credit card companies. Withdrawing money using their credit card, showing off 10-12 credit cards, when the purse is opened for payments at any counter, giving a smile to the person standing next to him(proving his superiority in terms of his high market value),extending the credit limits, is what the customers do.
Where does the disadvantage of credit cards lie? Paperwork, high cost fees, unexpected fees, hidden charges and no free lunches by the credit card company. Credit cards are actually meant for people who are very calculative and sensitive.
When credit card becomes a style statement then it turns into a foe and not a friend. Factors like peer pressure and a desire to rise up MASLOW'S ladder overnight, absence of any immediate responsibilities, easily available jobs, and disposable incomes make them forget values. Salaries are to fund minimum payments. So if you have multiple cards young transfer balances and withdraws cash to pay the bill of another.
The American scenario is worse. Jennifer Hicks says "Ten percent" of your take-home pay is considered a comfortable debt load. Fifteen percent might be manageable. But, if you're nearer to 20 percent (or more) you're probably in too deep and losing far too much sleep. In 1997, close to 1 million of those tired souls filed for chapter 7 bankruptcy according the Administrative Office of the United States Courts. Their average debt, not including their home mortgage, was $47,000--most of that in credit card bills. The result? Nearly $6 billion of debts were forgiven. Nearly all filers walked away with no credit and a blemish on their credit so severe, they'll need to rely on cash for all their needs for the foreseeable future and beyond.

Is Credit Card All That Bad?

No, depends on how consumers use. It is like giving a hand grenade to a person who is not trained for the job. Even the hard nuts to crack in the markets also melt down in front of the "temptation" of credit cards. The problems could be severe. Problems relating to families, colleagues, and society. You will have the worst nightmare of your life when you when the collection guys chase you. " Raw money into wrong hands".

Why do we do it? Are we changing?

The hard nuts also crack- in front of a demanding family, second cars, prestige, foreign holidays, and the list is on…. Why do we do it to ourselves. The reasons are 3 main ones:

- Snob Value
- Convenience
- Unwanted family pressure and the habit of "not waiting"

We focus on having the best and the slice from every cake. Second car, second house, movies at multiplexes, designer clothes, restaurants, jewelry. People try to proove Adam Smith wrong. "Unlimited wants and limited resources."
Your newly wedded wife has asked for a diamond ring, this valentines and it has to be urgent and immediate. Exotic vacations, luxury goods nothing seems to wait. A lot of people use their credit cards because it is easy. They would just wait for an opportunity when the guy at the counter asks, " This credit card is not working. Do you have another one?" Here it goes. You will see that the person will throw all his cards at the person at the counter to proove his superiority over the others standing at the counter. The problem, is that they are too convenient to use and at the end of the month you do not remember whether actually you have spend the money or not. Even if there are wrong entries you will not be able to suspect.

Companies know their marketing. They target our dreams, our fears, and our fantasies. They design their promotions to make us feel in heaven like "Your wife deserves this extra bit".

Today's society is flooded with material things. Today relationships start with gifting and end with gifting. There is no dearth of occasions to gift. We have adopted us to the Western philosophy so much, that somewhere we are loosing our value systems. Human beings have become more demanding. Although it is good for a country to grow, but at the same time it is loosening the social fabric of the nation. Families should be built on the basis of trust and value systems. But unfortunately, we are too busy earning and demanding, that the "time" for people has reduced.

Savings, is one more area that we are loosing out on. Today parents are not teaching their children the basics of savings and you find many people, with high incomes and low savings. Savings are not taught to us. Money in the hands of the youth, thanks to BPO's and call centers, have moved them to adopt a lifestyle of the West. The money that they earn is five figured, but the values they are loosing, can never be brought back into life.

If we read into the minds of the consumers, we would see that most of the purchases that we make, are either instigated or forced because of societal pressures. One of the reasons why credit cards, have grown to such an extent is because we have become increasingly "jealous". We do not leave within our means. We are not able to differentiate between emergency and no emergency. Whenever situation arises, we push our payments, using cards. But, do we not understand the damage we do to ourselves. The surprising fact is that, it not the uneducated who does this, it is the literate who constitute a greater percentage of this financial mess. People do not live in a realistic society. Even the ethical issues of advertisements needs to be challenged here. People want to be millionaires overnight. This is backed by strong peer, parental, spouse, children and societal pressures. Do we really need to proove anything to people? Is it worth it. Probably at the end of a lifetime we would regret the time we have lost to win over the materialistic world.

People do not understand credit cards

Around the world the interest rate on a credit card is significantly higher than a home loan. For example in the US the current average interest rate for a 30 year fixed rate home loan is around 6% whereas the average credit card interest rate is around 14%. This means that, in the US, a credit card is about 2.3 times more expensive than a home loan on an average. In comparison in India a credit card (at an average rate of 34%) is about 3.2 times more expensive than a home loan (at an average rate of 10.50%). What this comparison does not reveal however is that the lowest interest rate in the US on a credit card is around 7.50% p.a. which is not that far off from the home loan rate. In India however the lowest credit card rate is around 20% which is still twice the home loan rate.

There are various reasons for this anomaly.

1. The Indian rates are completely distorted by a 12.24% service tax on the interest charged on a credit card which is not charged (mercifully so) on the interest payable on any other kind of loan. So clearly a part of this problem is due to government taxes and the card issuing banks cannot be blamed for this.
2. Banks in India tend to charge the same rate for all credit card consumers irrespective of their credit profiles and payment history. Rate differentiation depending on past credit and payment history is just beginning to make its presence felt in India and this situation will correct itself to some extent in the future.
3. The biggest reason for the higher rates off course is the relative price inelasticity of borrowings through a credit card. In simple English it means that the kind of consumers who use a credit card to borrow from their banks care more about the convenience that is offered on a credit card and they either are blissfully ignorant of the actual interest rates charged to them or prefer to ignore the interest rate hoping to pay off the borrowing quickly. Since the actual amounts of borrowing on a credit card is normally small (around Rs. 25,000 to Rs. 50,000) the total

interest charged even at the stiff rates of 34% p.a. works out to between Rs. 800 to Rs. 1500 per month. Since the absolute amount looks small the lay consumer rarely bothers about calculating the actual interest rate.

4. A very interesting fact is that if the consumer spends Rs.50,000/- on a credit card and only pays off the minimum amount of 5% due every month then at an interest rate of 34% p.a. it will take him about 11 years to completely pay off the amount with the total interest payable at Rs. 57,000 during those 11 years being far in excess of the original borrowed amount of Rs. 50,000/-

Some other areas where most of the people are unaware are:

- Interest rates and understanding credit card cycles
- Freebies given to promote credit cards
- Hidden charges and costs.
- The fineprint of terms and conditions which we do not read

In Times of Emergency

After we have entered into the pit, what is the corrective measure. It is troublesome, painful, because you refuse to come back to the original state. But certain guidelines can be worked out. They are:

- It is your family. Build with values and not with materials.
- Borrow from cheaper sources to repay off the debt
- SAVE
- Use debit card and say no to credit cards
- Spend cash and leave within your means
- Use only in state of emergencies and with due diligence
- Be realistic about life and wants. Do not try and proove to people. It is not worth it.

Research

We surveyed a total number of 150 people. Out of the total number of respondents, 75 are small businessman, 15 from IT, 30 from ITES and 30 are professionals like Doctors and Teachers.

73% of credit card users are small businessman and 40% are ITES employee. All IT professionals use cards and doctors and teachers very infrequently use cards.

The IT people use credit cards mostly for revolving credit purpose.

32% of the small businessman uses at least two credit cards and 55% use a single credit card. The reason behind is higher purchasing limits.

ITES employees use credit cards, mostly as a lifestyle statement.

Credit cards are preferred by ITES employees for the sake of convenience and its easy availability.

Small businessman use credit cards for easy payment options (50%), easy availability (45%). Businessman and ITES employees use the credit cards most frequently at 50% and 45% of their transactions.

50% of ITES employees use credit cards for shopping and 40% for luxury items. The higher chunk of small businessman, 78.2% used their credit cards for shopping followed by 30% for luxury items.

30% of the ITES employees and 48% of the small businessman do not read the fine prints of the credit card document given to them.

71% of the small businessman and 70% of the ITES employees are aware of terms used in credit cards.

91% of the small businessman distinguishes between the taxes and the charges. It is 68% for the ITES.

Out of the respondents as high as 60% have never called up to the banks to clarify regarding extra charges.
The small businesses are most highly vulnerable to cash withdrawals at 48%.
100% of the small businesses have loans on credit cards, followed by ITES at 80%, and 67% for IT professionals.
83%of the small businesses are aware of the credit card charges, while it is 67% and 50% for IT and ITES professionals respectively.
As high as 67% said that the receipt of credit card statements are late.
78% of the credit card users verify their credit card statements before making payments.
One more shocking revelation that we had was that 30% of the statements generated are with defaults.
33% of the IT professionals are unaware of the interest charges, which is 30% for ITES employees and 22% for small businesses.
Most of the respondents have an additional expenditure of Rs 5000 to Rs 12000 with the credit cards.

RBI Guidelines to Credit Card Issuers

All banks and NBFC has been instructed a have a well documented policy and fair practice code for credit card operations. The key issues that have been discussed are:

- Assess the credit risk while issuing cards to persons, especially to students and others with no independent financial means. (It is still today not done. How can you assess the credit risk of a person who does not want to voluntarily disclose it? Sales executives discourage such risk assessment exercise, by setting up with the scene with prospective card holders.)
- Banks should assess the total credit availability to cardholders through a self declaration form. (Not done)
- Banks would be held responsible for KYC norms, for its DSA's and DST's. (Do they know what is the full form of these terms?)
- The terms and conditions for issue and usage of a credit card should be mentioned in clear and simple language (preferably in English, Hindi and the local language) comprehensible to a card user. (Yes, this has been done. However consumers are never encouraged to read it.)
- There should be no delay in dispatching bills and the customer has sufficient number of days (at least one fortnight) for making payment before the interest starts getting charged. (Still today, bills reach customers late, due to multiple reasons and get penalized. Customers generally do not find the time to complaint.)
- Card issuers should quote annualized percentage rates (APR) on card products (separately for retail purchase and for cash advance, if different). The method of calculation of APR should be given with a couple of examples for better comprehension. (In monthly statement as well as welcome kit). (Yes, this has been done. But examples are still not given.)
- The bank should not levy any charge that was not indicated to the credit card holder at the time of issue of the card and getting his / her consent. (Even free credit cards, charge initial processing fee)
- Changes in charges (other than interest) may be made only with prospective effect giving notice of at least one month. (This has been done)
- The card issuer should ensure that wrong bills are not raised and issued to customers. In case, a customer protests any bill, they should provide explanation and, if necessary, documentary evidence to the customer should be provided within a maximum period of sixty days. (Consumers encounter frequent wrong bills, and try calling the call centre to believe how much trouble they can cause to you).
- Unsolicited cards, loans, upgrade credit cards and enhance credit limits or other credit facilities should not be issued. (Not done)

- They should maintain a Do Not Call Registry (DNCR) containing the phone numbers (both cell phones and land phones) of customers as well as non-customers (non-constituents) who have informed the bank that they do not wish to receive unsolicited calls. (I need not answer this.)
- The DSA's as well as its Call Centers have to first submit to the bank a list of numbers they intend to call for marketing purposes.(They never do it. Even if rule book says so, it is passed on from one sales executive to another.)
- The card issuing bank should not reveal any information relating to customers obtained at the time of opening the account or issuing the credit card to any other person or organization without obtaining their specific consent. . In case of providing information relating to credit history / repayment record of the card holder to a credit information company (specifically authorized by RBI), the bank may bring to the notice of the customer that such information is being provided in terms of the Credit Information Companies (Regulation) Act, 2005.(Data is transferred from one bank to another though contacts. Going by the official channel can take days, but this can be easily avoided if there is a mutual understanding between employees of competing banks)
- Banks and their collection departments should not resort to harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the credit card holders' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations. (Try passing through the collections and recovery department to find out the language employees of MNC banks use. In case you do not believe this, do it yourself. Every month there is a list that comes to the collection manager. Out of Rs 100 of default, you must recover back Rs 80. That's you target.)
- Redressal of grievances.(Lets not discuss that)

Conclusion

Today looking from the point of view of an academician, I find myself in a shock. People are living beyond their means. Spending money which they cannot afford. It is giving a habit of unchecked spending. If this is not stopped then people are definitely going to have a tough time when they will have no other means of paying back.

The purpose of this research is to find out the relationship of income with the amount of spending through credit card, general understanding of credit card system, degree of living beyond the means, and problems faced in the usage of the credit cards. A survey of individuals across different age group and profiles to validate the same. The study is to know three important things:

1. How fast or slow is the process of "debt trap" occurring?
2. What is the extent to which people are living beyond the means?
3. Which are the set of customers who are more prone to the habit of credit cards?

What we need is more awareness among people. RBI should be strict in the disclosure norms of credit card companies. If immediate steps are not taken, we definitely are heading towards "hara-kiri". Let us not make the Indian value system of **"Savings"** like the **"Credit"** of the west.

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