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Effects of Credit Card Incentives on Consumer Borrowing In Kenya: A Case of Commercial Banks in Kenya

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ABSTRACT
Financial institutions have mainly relied on incentive programs as their main strategic driver to increase electronic payments, such as through use of credit cards. Credit cards have been globally acclaimed for their benefits that range from their ability to ensure tax-compliance, security, instant cash and their ability to facilitate settlement of cross-border transactions. However, there exists a great challenge of credit card usage, such as ease of accumulation of debts and high interest charges. The purpose of this study was to determine the effect of credit card incentives on consumer borrowing in Kenya. The study employed a descriptive study approach using a sample size of 18 commercial banks offering credit card services. Self-administered questionnaires were used to collect information. Credit card incentives were found to be a major contributor to credit card uptake. The study also found that most banks used incentives such as rewards for repeated use, low interest rates, traveling awards and benefits to influence the spending behavior of their clients. The study found credit card also affected spending behavior. It is concluded that credit card incentives can be effectively used by banks to increase use of credit cards. It is recommended that financial institutions should educated their customers on how to use their credit cards so that they do not fall into a debt trap.

Key words: Incentives, Credit Cards, Consumer Spending, Consumer Borrowing, Consumer Indebtedness

INTRODUCTION

A credit card can simply be regarded to as a token issued by a financial institution, giving the holder the option to borrow funds usually at point of sale. Credit cards are widely used in international business and are strongly recommended by national Central Banks that are keen to promote the use of non-cash and more efficient payment systems, flexibility and security (Payments Council, 2010). Credit cards are as well viewed as instruments that can contribute to the promotion of financial inclusion as has been clearly demonstrated in economies where cards are a common tool for the settlement of financial transactions.

In the United States, it is estimated that 80% of households have at least one credit card (Bolt & Chakravorti, 2008). In Africa, with the growing emphasis on trade within the regional economic groupings like EAC, COMESA and SADC, plastic money in the form of credit cards is gradually becoming a practical way of facilitating settlement of cross-border transactions. The extensive use of the mode of payment also has the potential to increase tax compliance among the retail and wholesale sectors (Ng'andu, 2013).

To increase the uptake of credit cards, financial institutions use credit card incentives. This has, however, encouraged impulsive purchase behavior among customers (Munyoki & Okech, 2012). It is in view of this that this study seeks to contribute to the understanding of effects of credit rewards on consumers' borrowing, by exploring the effects the credit card incentives have on the use of credit cards, consumer spending behavior and consumer borrowing levels in Kenya.

LITERATURE REVIEW

According to Chakravorti (2003) credit cards users often receive incentives such as dispute resolution services, frequent-use awards, and interest-free short-term loans. This incentives act is viewed as an attraction point for new users and therefore increasing uptake. Credit cards also provide various security features and limit consumer liability in the event of fraudulent use making it a preferred payment method in comparison to cash. Gurusamy (2007) also indicates that credit cards can be considered as a good substitute for cash or cheques.

Chakravorti (1997) indicates that credit cards had initially been introduced as a credit instrument but the concept later grew to become an extremely popular payment instrument. According to Hayashi (2008) credit card usage has more than 25 years of history in countries like the United States and that as competition for cardholders has continuously intensified, card issuers have been making reward programs and incentives more generous. Hayashi (Hayashi, 2008) explains that this is evident in the specific positioning of credit cards in reference to geography, class and business environment. The explanation for this is because credit cards operate on a platform that involves different players. Chakravorti (2003) highlights the participants in the credit card networks as the consumers, issuers, merchants, acquirers, and network operators. These participants are involved in a series of interrelated bilateral transactions that offer them different benefits.

According to Chakravorti (2003) credit cards are innovated tools of the credit function of financial intermediaries which instead of having the bank and person receiving the credit, other participants are also involved. This along with rewards given to card users by financial intermediaries can also impact on the costs of using the cards. Payment card rewards play different roles depending on the maturity of the payment card industry. When the industry is in its infant stage, rewards can be used to induce consumers to adopt the cards. Rewards may also help consumers learn the various features of the card. When the industry matures, rewards may still induce consumers to switch to payment cards from other means of payment, such as cash and checks. If rewards are set appropriately, then rewards may positively affect consumers, merchants, and the payments system as a whole—but, if not, rewards may potentially harm them.

According to Yoo (1998) credit cards have become an accepted common form of payment in most of the world. Evans and Schmalensee (1999) show that credit cards have become more common over time: Between 1970 and 1995, the fraction of households in the United States with at least one credit card rose from 16 percent to 65 percent. This is also accompanied by an increase in ratio of credit card charges to income and amounts owed on a credit card. However, Katz (2001) indicates that credit and charge card users generally pay transactions fees that are below marginal cost and that many cardholders face negative prices for using their credit cards and these negative prices are the result of rebates and rewards programs.

In assessing the benefits accrued from rewards given to new credit card users Hayashi (Hayashi, 2008) indicates that rewards can also help introduce consumers to the various features of the card. When payment cards were new, many consumers were not fully aware of their benefits such as the transaction speed, convenience, security, record-keeping ease, and float. Consumers who were unfamiliar with a card were likely to undervalue its benefits and may have chosen another payment method, such as cash or checks. But with rewards as an incentive, many consumers soon learned the value of payment cards. Once the benefits of the cards became clear, some consumers may have kept using them even without receiving rewards.

According to Gurusamy (2007) credit card rewards may also play a role even after the industry matures and consumers become aware of the benefits of using a card. In the payment market, consumers choose a payment method from a set of payment methods that merchants accept. While the consumer’s choice of method affects the merchant’s benefits and costs, the consumer does not consider these factors when choosing a payment method. Rewards, however, can be set to reflect the merchant’s benefits and costs. Thus, they can influence a consumer to choose a method that provides a benefit to the merchant.

Credit Card Incentives and Consumer Spending

Much of the previous research on the use of credit cards has focused on the difference between credit cards and other forms of payments on consumer spending. Prelec and Simester (2001) and findings from Soman and Cheema (2002) show that when the decision to purchase has been made, the use of a credit card leads to more spending than cash or checks.

In the modern era of commerce, the use of credit cards to make payments has become a normal practice as pointed by previous literature (Gurusamy, 2007; Hayashi, 2008). The proliferation of credit cards and their ease of access have given consumers increased opportunities for making credit purchases. Over the past two decades, the use of credit cards has become an area of economic and social concern. The problems created by credit card usage have caused apprehension among educators, consumer advocates, and public policy administrators. Economic concerns have risen in part, as a response to the massive use of credit cards and the accumulation of debt in American society that was a contributor to the recent credit crunch experienced in the United States and parts of Europe. The most striking feature of this trend has been in the U.S. household indebtedness and rise of personal bankruptcy (Manning, 2000). According to the American Bankruptcy Institute (American Bankruptcy Institute, 2010) more than 1.35 million people filed for Chapter 7 or Chapter 13 bankruptcy in the United States during 2011, which equates to approximately one in every 175 adult Americans.

With regard to social concerns, the use of credit cards in society has affected not only traditional consumers, but also vulnerable groups, such as college students, senior citizens, and disabled citizens. College students have grown up in the age of credit, becoming independent consumers earlier in life, and constantly exposed to new products and services available through credit cards. Along with technology and the expansion of the Internet, they became an appealing demographic group for credit card companies and financial institutions for a variety of reasons. Solicitation on college campuses has caused concern among college officials, consumer advocacy groups, and legislators (Mansfield & Pinto, 2007; Robb & Sharpe, 2009). Other than the work of Mansfield and Pinto (Mansfield & Pinto, 2007), there has been a lack of empirical studies with developmentally disabled individuals due to the problem of inaccessibility. These social and economic concerns have raised the level of awareness that credit cards have both positive and negative consequences for individual consumers and for society as a whole.

Credit card incentives on indebtedness

Since the increase in personal debt is an on-going process, many scholars, economists and financial analysts have shown their concerns towards controlling it in order to protect the economy of the country from its harms (Munyoki & Okech, 2012). There are various ways through which individuals incur debts among them use of credit cards, getting personal loans, bank overdrafts, among others (Gross & Souleles, 2002). In general if consumers feel peer pressure toward conspicuous consumption, a higher level of consumption may be exhibited forcing them to incur debts. The debt of this nature is considered unfavorable and counter-productive to an economy (Cameron & Golby, 1990). Similarly, this type of expenditure is undesired economical since it is bound to contribute towards increased demand for consumer goods and if not checked on time, may contribute towards inflationary conditions.

Credit card debt has been reported as the main reason causing Americans to file for personal bankruptcy (White, 2007). On a positive note, some scholars on the other hand, consider personal debt as being positive to an economy. This kind of expenditure allows households to expand their purchasing power which in the process lead to an increase in production of goods, and hence creation of employment of opportunities and finally economic growth. It is also argued that consumer debt allows the smoothing of consumption over a household's life cycles, and is therefore stabilizing for the economy and has a positive effect on consumer welfare. At the level of the household, for instance, some argue that increases in consumer debt accords poor households an opportunity to access basic needs especially in times when their spending capacity declines. In developed countries, it is noticed that the most of the young individuals aim to borrow from different financial institutions to finance their studies, buy homes just after graduating, *etc.* The motivational force behind this borrowing is that they expect to earn higher incomes in future and believe that would enable them to repay these loans (Gobel, 2010).

Gervais (2007) observes that the borrowing pattern of French household was attributed to various factors. First, the increase in population size especially at household was considered the most significant factors. This according to the study, contributed towards high demand for accommodation which consequently led to an increase in the number of families in need of new houses. Other factors were government policies toward household loans which were considered amongst households as being flexible.

RESEARCH METHODOLOGY

The study employed a cross sectional descriptive study approach. The population of the study included commercial banks registered and having operations in Kenya. According to the CMA **(**2012**)** there were 44 commercial banks registered in Kenya as at 31st December 2011. The target population was banks that offer credit card facilities to their clients. The Kenya Credit and Debit Association members include 18 commercial banks that offer the credit cards to their clients. The study's target population was therefore the 18 commercial banks that offer credit card services. All the 18 commercial banks were included in the study. Data was collected using self-administered questionnaires.

DATA ANALYSIS

A total of 18 questionnaires were distribution to commercial banks registered with the Kenya Credit and Debit Association. All the questionnaires were returned duly filled. The results showed that 64% of the banks that have credit facilities in Kenya are foreign owned. Hayashi (2008) explains that credit card usage has more than 25 years of history in countries like the United States and European countries. This can explained why more foreign banks offered credit card facilities as compared to local banks.

It was also found that 57% of the banks indicated that they had offered credit card facilities for between 4-10 years, while 43% said they had offered the same services for between 1-4 years. The data show that the credit card service has not been in existence for long in Kenya as compared to other countries like the USA where visa cards were introduced in the 1960s (Garcia, 1980).

On whether they used credit card incentives to attract customers all the banks indicated that they used them to some extent. This finding means that Kenyan bank use credit card incentives to attract customers. This seems to agree with Chakravorti (2003) findings that credit card incentives have become popular. Lower interest rates, promotions on use of cards, cash back, waiving of fees, discounts and auto debit facilities were some of the credit card incentives that were identified.

All the respondents said that, the choice of the card to use was greatly influenced by the incentives offered. Gurusamy (2007) notes that credit card rewards can be set to reflect the merchant's benefits and costs and therefore influence a consumer to choose a method that provides a benefit to the merchant. About 72% of the respondents indicated that credit card incentives greatly influenced their credit lines. More customers were willing to take credits cards with higher limits due to the incentives. About 71% indicated that, credit cards incentives affected the process of renewals to a great extent. Due to the incentives cards are easily renewed by the customers.

The use of incentives has a great influence on the uptake process of secured credit cards. About 71% of the respondents indicated that that the use of incentives impacted to a greater extent the uptake of the cards. This agrees with Chakravorti (2003) who said that incentives can be used to attract new users.

All respondents agreed that credit cards incentives influenced to a greater extent the spending behaviors of the customers. Majority of respondents were of the opinion that the use of incentives had a moderate influence on spending behavior as shown by 64% in, while 29% said it has a great extent of influence and 7% a very great extent of influence. The findings coincide with Mansfield and Pinto (2007) who show that credit cards have both positive and negative consequences for individual consumers and for society as a whole.

When asked the extent to which they reviewed reports detailing customer spending, 50% said it was done to a very great extent while another 50% said to a great extent, clearly showing that banks understand the influence that incentives have on spending behavior of customers. This means that banks are concerned with the use of credit cards. This view is supported by Gurusamy (2007), Hayashi (2008) and Chakravorti (2003), who say that the use of credit cards has become an area of economic and social concern and the problems created by credit card usage have caused apprehension among the issuers, consumer advocates and public policy administrators.

All the respondents said that credit cards incentives influenced customer spending. This is shown by 71% of the respondents indicating that the incentives influenced spending to a great extent and 29% indicating that they influenced spending to a very great extent. The findings relate to those of Gurusamy (2007) who notes that economic concerns have risen in part, as a response to the massive use of credit cards and the accumulation of debt in society that was a contributor to the recent credit crunch experienced in the United States and parts of Europe

It was found that the commonly used criteria to assess acceptable levels of debt by card holders was use of the level of income and account history. About 71% said that ***C***harge off policies and recoveries were to a very great extent outlined in the credit policy of the institution for mitigated indebtedness due to credit cards, 64% said that they used fixed payment programs and fraud control.

On whether customers' indebtedness can be blamed on the credit card incentives, 64% of the respondents indicated that it is to a small extent that they can ascribe indebtedness to incentives while 36% say to not extent at all. This agrees with Prelec and Simester (2001) findings that credit card use is not solely to blame for high indebtedness amongst consumers.

DISCUSSION OF FINDINGS

The findings show that credit card incentive influenced the type of credit card used by a consumer in regards to the authorizations, credit lines, renewals and payment deferral plans. The use of credit card incentives further greatly influenced the uptake of cards including the general purpose cards, corporate cards and secured credit cards. The findings also show that credit card incentives were a major contributor to credit card uptake. This agrees with findings by Prelec and Simester (2001) and Soman and Cheema (2002) findings which show that when the decision to purchase has been made, the use of a credit card leads to more spending than cash or checks and incentives further increases the need to spend more.

The findings of the study indicate that credit card incentives have a direct relationship with spending behavior of consumers. The study found that most banks offering credit card facilities used rewards for repeated use, low interest rates, traveling awards and benefits to influence the spending behavior of their clients. This shows that credit card payments have become an acceptable form of payment and thus encouraged by financial institutions that can use it as a way of diversifying their credit facilities (Dubé, Hitsch, & Rossi, 2009).The study has also revealed that banks reviewed their clients spending behavior very regularly mainly because of the influence the incentives has on the spending behavior.

The study finds that banks have policies concerned with mitigating indebtedness which emphasize on fraud control, fixed payment programs as well as recoveries and charge off policies. This is also in line with findings by Chakravorti (2003) who indicates economic concerns have risen in part, as a response to the massive use of credit cards and the accumulation of debt by customers.

CONCLUSIONS

The study finds that credit card incentives used by commercial banks will have an influence on the credit card uptake and spending behavior of users. However banks have set adequate policies and rules that mitigate the issue of bankruptcy from credit cards but limited to credit limits and policies related to recoveries. Indebtedness has been ascribed to other factors such as poor planning. The study concludes that credit card incentives can be effectively used by banks intending to increase the spending of their clients through credit cards and in increasing the number of people using credit card as the form of payment.

RECOMMENDATIONS

It is recommended that financial institutions should educate their customers on the proper use of the credit cards so that they do not make excessive borrowing and fall into a debt trap.

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