Keeping Consumers in the Red: Hedonic Debt Prioritization Within Multiple Debt Accounts

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Prior literature has demonstrated that consumers behave irrationally by paying down smaller balances instead of higher interest balances. Across three experiments, debt type (hedonic versus utilitarian) exacerbates the effect and we document anticipated consumption enjoyment as a mediator. Further, timing of the debt moderates debt type effects on account aversion.

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EXTENDED ABSTRACT

The current studies extend the stream of research on debt account aversion (Amar et al. 2011) by investigating how people manage multiple debts and how they prioritize their debt repayment depending on the type of debt (referred to as ‘debt type’ hereafter) and timing of debt occurrence. In particular, we demonstrate that when debt is incurred for a hedonic purchase (as opposed to a utilitarian purchase), customers with multiple credit card debts are more likely to reduce the number of debts by prioritizing small debt repayment rather than decrease the total cost of debt across accounts. Thus, we explore the effect of ‘debt type’ on ‘debt account aversion.’

When consumption benefit depreciates over time (Gourville and Soman 1998), continued payment feels more like a pure loss since there is no corresponding benefit to buffer the pain of repayment. Kivetz and Simonson (2002) demonstrate that the pain of payment is more pronounced for hedonic consumption than for utilitarian consumption. Also, individuals quickly adapt to an enjoyable consumption, since hedonic experiences depreciate more quickly than utilitarian experiences (Wang, Novemsky, and Dhar 2009). Thus we predict that hedonic debt will motivate consumers to pay down smaller balance debt accounts faster than an equivalent debt for a utilitarian purchase and that this effect is mediated by the degree to which the consumer feels consumption enjoyment will be impacted by debt. When the smaller debt has a high APR (thus aligning account aversion with optimal overall debt reduction), we predict and find no differences between hedonic and utilitarian debt.

Study 1 manipulated both debt type and APR. Participants were presented with two debt accounts (hypothetical credit cards) that varied in outstanding amount and corresponding APR. Subjects had $600 in their savings that could be allocated entirely (or partially) toward one (or both) credit card balance(s). Participants could completely pay off (close) one of the debt accounts if they desired. Half the participants saw credit card M with $600 balance and 12% APR and credit card S with $1200 balance and 18% APR. The order of APR assignment for the other half of the subjects was reversed, such that credit card M had $600 and 18% APR and credit card S had $1200 balance and 12% APR. Across all conditions, the $1200 on credit card S was due to everyday purchases. Debt type was manipulated by telling one half of the participants that the $600 debt on credit card M was incurred because of a luxury (technology) package upgrade to the current vehicle. Proportion of savings allocated to the smallest balance served as the dependent variable. The results (Table 1) of this study revealed that in the 12% condition, hedonic debts were prioritized and repaid faster than utilitarian debts. No differences were observed in the 18% condition. As hypothesized, hedonic debt reduced anticipated consumption benefit, which mediated the debt type-repayment relationship.

Study 2 manipulated anticipated consumption enjoyment by utilizing temporal construal (Trobe and Lieberman 2003) in 2 (hedonic v. utilitarian) x 2 (12% v. 14%) x 2 (debt timing: recent past v. distant past) design. If retaining consumption benefit is the motivation behind repayment of hedonic debt, debts occurring in the distant past should be prioritized over debts occurring in the recent past. This is because the elapsed time between consumption benefit and payment reduces the utility of hedonic purchases much more than that of utilitarian purchases (Kivetz 1999). The APR manipulation was similar to that in Experiment 1. Depending on the type and timing of debt, participants were told that the card M debt was incurred because they had purchased a laptop for a fun-oriented purpose such as gaming (work-oriented purpose such as office tasks) last month (last year). Results revealed a significant three way interaction such that in the 12% condition, hedonic debts were prioritized over utilitarian debts—especially those occurring in the distant past. Debtors were more likely to repay hedonic debt due to the diminished consumption enjoyment, further amplifying debt account aversion effects. The anticipated consumption enjoyment provides process evidence and is consistent with research that shows that elapsed time between the consumption benefits and payment (e.g., “decoupling”) reduces the utility of hedonic purchases much more than those of utilitarian purchases (Kivetz 1999; Patrick and Park 2006).

Study 3 tests the proposition that people are more willing to pay off the debt associated with past hedonic consumption than future hedonic consumption, as consumers tend to be overly optimistic when forecasting future behavior (Dhami, et al. 2006; Khan and Dhar 2007). Wang, Novemsky, and Dhar (2009) demonstrate that consumers are unable to accurately predict diminishing hedonic enjoyment because they fail to account for adaptation. The design was similar to that of study 2, but replaced recent/distant past with past/future in a 2x2x2 design. Results again revealed a significant three way interaction such that in the 12% past condition, hedonic debt was prioritized over utilitarian, however future debts were treated equally. As in both prior studies, no differences emerged in the 18% condition. Mediation analysis again supported the proposition that hedonic debt negatively affects anticipated consumption enjoyment, which increases the likelihood of closing out the smaller account despite it having the lower interest rate.

Overall, these results reveal the detrimental effects on consumers’ ability to reduce overall debt; the temptation to pay off past, hedonic debts may override optimal allocation intentions and keep consumers in debt longer than necessary.

REFERENCES


