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Competence in Consumer Credit Products: A Suggested Definition

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Abstract

The credit product market has become increasingly complex and in it consumers face many choices when using credit. Therefore, consumers must become more competent to choose and use such products. But what exactly does competent mean? There are many definitions of competency in the field of consumption but none particularly target consumers and their use of credit. The purpose of this paper is therefore to present an exhaustive definition of competence in the usage of consumer credit products.

Keywords

Competency, consumer credit, personal finance

Purpose

The credit product market has become increasingly complex and in it consumers face many choices when using credit. Therefore, consumers must become more competent to choose and use such products. But what exactly does competent mean? There are many definitions of competency in the field of consumption but none particularly target consumers and their use of credit. The purpose of this paper is therefore to present an exhaustive definition of competence in the usage of consumer credit products.

Methods

To meet the goal of this paper, it is useful to first inventory existing definitions. The first step is to find definitions of competence in consumer studies using keywords such as “consumer skills” or “consumer expertise,” “competency,” and “competent consumer/consumption.” Because competency is a multidimensional concept, the second step is then to define each dimension: cognition (keywords: cognitive, cognition, and knowledge), affect (keywords: affective, emotions, feelings, and attitudes), and behavior (keywords: behavior, credit use, debt, credit

cards and loans). The search engines used were Google Scholar, PsycNET, and ERIC. A total of 25 articles, 8 reports, 1 thesis, and 5 books were consulted. When relevant, the function *cited by* was used to find more recent articles.

Pertinent data about the research

Credit exists in several forms

First of all, credit can be used for two distinct purposes: consumer purchasing and real estate. The following section will cover only credit used for consumption. According to the U.S. Federal Reserve Board, consumer credit includes short and intermediate terms for individuals, and does not include loans secured for real estate (Organisation for Economic Co-operation and Development 2005). The European Union's definition lists all products included in consumer credit: credit card use, foreign currency loans, payday loans, consumer installment loans (which include borrowing for education and can thus be considered a human capital investment), hire purchase loans, overdraft facilities, revolving/rolling credit, financial leases and other types of consumer credit (auto loans and loans for purchases of consumer durables; Organisation for Economic Co-operation and Development 2005).

Definitions of competence

Competence is a concept that exists in many fields. For example, in psychology, Heinsman and colleagues (2007) examined three dimensions of competence in the context of employee selection: cognitive ability, personality, and performance. In education, Scallon (2004) defines competence as a mobilization of knowledge, expertise, and way-of-being used to solve tasks. In sociology, Waters and Sroufe (1983) state competence as being a coordination of personal resources (cognitions, behaviors, affect) in order to reach satisfactory objectives. In short, competence is a concept composed of more than one dimension.

Definitions of competence in consumer studies

Though many authors propose definitions of competence in consumer studies, these have little in common. One of the most cited characteristics of a competent consumer is marketing literacy (Alba and Hutchinson 1987; Grønhøj 2007; Lachance and Legault 2007; Macdonald and Uncles 2007). A marketing-literate consumer is critical of advertising and understands commercial influence.

Another characteristic typical of a competent consumer is his or her likelihood to seek out information before buying (Bonnemaizon and Batat 2009; Grønhøj 2007; Lachance and Legault 2007). Also, the consumption must present rational motives and must be related to the

consumer's needs (Alba and Hutchinson 1987; Batat 2010; Grønhøj 2007; Lachance and Legault 2007). Financial skills, such as handling money or dealing with credit terms, are also recognized as a characteristic of competence by some studies (Batat 2010; Bonnemaizon and Batat 2009), but it would seem that researchers have paid rather little attention to this aspect (Grønhøj 2007).

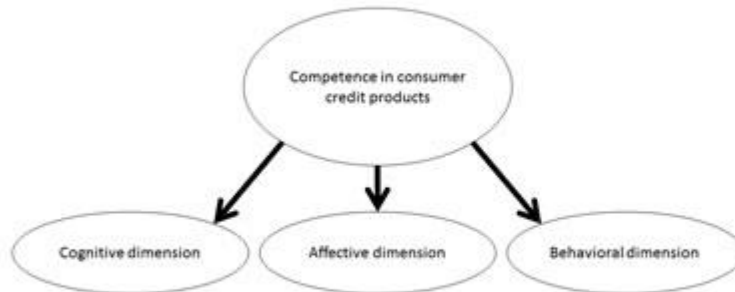
Networking constitutes another characteristic that authors highlight. Consumers must be in contact with useful people who are expert in buying goods or services (Batat 2010; Garnier and Macdonald 2009; Macdonald and Uncles 2007). Also, they must know how to deal with salespeople (Batat 2010; Bonnemaizon and Batat 2009). Networking through social media, such as Facebook, Twitter, or Wikipedia, constitutes another aspect of networking (Garnier and Macdonald 2009; Macdonald and Uncles 2007). With social media comes the importance of having computer skills as consumers must not only know how to interact on social media but also on company websites to place orders or do banking (Batat 2010; Garnier and Macdonald 2009; Macdonald and Uncles 2007).

The majority of the characteristics mentioned above are preventive behaviors, i.e., carried out before buying. Lachance and Legault (2007) include some defensive behaviors, such as complaining when dissatisfied with a product or a service. In short, authors would seem to agree on the characteristics of competent consumers.

Competence in consumer credit products

Based on the previous definitions, competence in consumer credit products could be conceptually defined as a multidimensional concept composed of cognitive, affective, and behavioral dimensions where the consumer adequately uses credit products. Figure 1 shows how the three dimensions appear to create a competency latent variable. This definition is in keeping with the notion of competence as discussed earlier. Multiple dimensions are vital in effectively measuring competence, given that each brings new information and contributes to painting the overall picture of an individual's skills (McKay 2011). Studies all examine the cognitive, affective, or behavioral dimensions, though none of the authors define any dimension precisely. The following paragraphs aim to dissect these three dimensions in the goal of better understanding them and will present several findings regarding consumption of credit products.

Figure 1. Competence as a latent variable composed of three dimensions



The multidimensional nature of competence

Cognition

There are many ways to talk about cognition (e.g. beliefs, cognitive appraisals, cognitive structure or processes). It would appear there is a thin line between affect and cognition. Indeed, some authors talk about affective beliefs or expected emotions as cognitions (Ahn 2010; Alba and Hutchinson 1987, 2000; Cohen, Pham, and Andrade 2008). Following their expected affect, individuals will choose options or behaviors according to the consequences of these latter on the change or maintenance of affect (Cohen et al. 2008). For example, some reasons that lead people into debt are their lifestyle expectations, perceptions of luxury or needs, or norms regarding acceptability (Livingstone and Lunt 1992). Alba and Hutchinson (1987) define cognitive structures as beliefs about product attributes while Ahn (2010) refers to cognitive beliefs as expected emotion. The pursuit of happiness — a kingpin of materialism that greatly influences the use of credit — is a good example of an expected emotion (Norvilitis et al. 2006).

Cognition presents a function of evaluation, otherwise named cognitive appraisal (Derbaix and Pham 1989). Individuals evaluate how relevant it is to analyze the options' attributes but they also evaluate each option's attributes (Alba and Hutchinson 1987, 2000). For example, before using credit, an individual has to understand the cost of credit and be aware of the benefits and the risks of debt (Sarra 2011). An explicit way to measure cognition is by the individual's self-reported assessments of attributes or prospective behaviors (Dimofte 2010). But, as Dimofte (2010) points out, individuals may have difficulties accessing their own cognitive processes or information stored in memory, resulting in biased self-assessment. It is then recommended to use implicit measures to better find underlying processes (Dimofte 2010).

Another aspect of cognition is cognitive know-how. This refers to the ability to read, interpret, store, process and organize information to maximize an individual's satisfaction (Batat 2010; Curbatov, Louyot-Gallicher, and Bonnemaizon 2010). Alba and Hutchinson (1987, 2000) refer to cognitive structure as ways in which knowledge is organized. For example, people use category structures (in other words, evoked set, usage situation, product class, or benefit segment) to differentiate options and make decisions (Alba and Hutchinson 1987, 2000). According to Lusardi, Mitchell, and Curto (2010), cognitive ability is strongly linked to financial knowledge. When making decisions, individuals tend to avoid cognitive effort and use strategies such as relying on affect referrals (Argyriou and Melewar 2011). Others have a high level of need for cognition (Petty, Briñol, Loersch, and McCaslin 2009).

"Need for cognition" is primarily conceptualized as a need for structure. Its definition has evolved and at present represents "stable individual difference in the tendency to engage in and enjoy cognitively effortful activities across a wide range of domains" (Petty et al. 2009). People with a low need for cognition use simple cues, such as stereotypes;scrutinize information only if personal relevance is high; and use less metacognition (Petty et al. 2009). Conversely, people with a high need for cognition engage in more thinking, possess stronger attitudes, and rely on more information to process (Petty et al. 2009; Monroe 2005). Means for acquiring information are multiple but can be divided in two categories: direct and browsing (Monroe 2005).

Direct information refers to all activities individuals carry out to voluntarily find information about a product or service. Browsing refers to acquisition of information through casual activities without having a specific goal (Monroe 2005). Many reasons lead people to seek out information, including a large quantity of information and variety, budget constraints, time pressure and price. Reasons for browsing differ: to build a bank of information, to stay abreast of developments or to conduct a formal direct search (Monroe 2005). The level of financial knowledge depends on the sources of information consulted (Kramer 2010). All this acquired information creates a pool of knowledge that individuals use in their analysis.

According to Monroe (2005), there are two types of knowledge: market knowledge (knowledge of specific products) and knowledge on how to find information. In personal finance, some people feel that information is difficult to find (Organisation for Economic Co-operation and Development 2005), which probably indicated they do not know where to look. Knowledge can be measured objectively and subjectively. While the former refers to accurate stored information, the second refers to self-beliefs about one's own knowledge (Carlson, Vincent, Hardesty, and Bearden 2009). Using a meta-analytic procedure, Carlson and colleagues (2009) found that objective and subjective knowledge are correlated (r=.37). Correlations differ depending on product type, the referent when evaluating individuals' own knowledge (self vs. others), and type of item (multiple choice vs. true-false) used in measurement (Carlson et al. 2009). Caution must be taken on financial questions. Indeed, consumers report knowing more than what they really do

know (Organisation for Economic Co-operation and Development 2005). However, it seems that credit knowledge and level of debt are not correlated (Jones 2006).

Affect

An affect is an internal feeling state and a generic term for emotion, mood, personality characteristics, attitude, preference, and evaluation (Cohen et al. 2008; Pieters and Van Raaij 1988). Four major functions of affect in economic behavior have been distinguished (Pieters and Van Raaij 1988). The first function is interpretation and organization. The way an individual feels gives him or her information about what is happening (Greifeneder, Bless, and Pham 2011; Pieters and Van Raaij 1988). Also, a high level of arousal helps complete a task (Cohen et al. 2008; Pieters and Van Raaij 1988). A second function of affect is mobilization and allocation. When an individual feels emotion, his or her resources can be mobilized or inhibited. For example, when an unexpected sound is heard, triggering a feeling of fear, one person might freeze while another might run away (Pieters and Van Raaij 1988). A third function of affect is sensation seeking and avoiding. Depending on how an individual feels, he or she may be risk averse or risk seeking (Ahn 2010). One study found that debtors presented a lower level of risk-seeking and sensation-seeking (Tokunaga 1993). The goal pursued is an optimal level of arousal, i.e. avoiding extreme stress or boredom (Pieters and Van Raaij 1988). The fourth and final function of affect is communication. An individual's expression of affect via sounds or body language tells others how he or she feels (Pieters and Van Raaij 1988).

Pieters and Van Raaij (1988) make a distinction between feelings that are linked to the person (mood, personality characteristics, and emotion) and those linked to the target (attitude, preference, and evaluation). Mood appears while there is no specific cause or after a combination of small events (Pieters and Van Raaij 1988). For some people, creating a good mood leads to money problems (Livingstone and Lunt 1992). Personality characteristics come from socialization processes and past experience (Pieters and Van Raaij 1988). Optimism, intra-/extraversion, and locus of control are examples of personality characteristics. For instance, heavy credit card users are likely to feel that their problems stem from an external source (Tokunaga 1993). Emotion is defined as an affective reaction or response to particular kinds of adaptive problems, persons, experience, or messages (Griskevicius, Shiota, and Nowlis 2010; Pieters and Van Raaij 1988). People facing a life-changing event are more emotionally affected and therefore run a higher risk of making poor financial decisions (National Endowment for Financial Education 2001). Ahn (2010) distinguishes between two types of emotions. The first, expected emotions, were examined in the cognitive section of this paper, while the second, immediate emotions, represents genuine affective responses that can in turn be divided into three types: integral, incidental, and task-related.

An integral feeling is directly linked to the object. For example, one can feel favourable to a specific brand (Ahn 2010; Cohen et al. 2008). An incidental feeling is unconnected to the object of decision; for example, feeling happy on a sunny day. Mood appears frequently as an incidental feeling (Ahn 2010; Cohen et al. 2008). A task-related feeling is elicited by the process of decision-making. For example, when a person has to choose between two options, stress can appear (Ahn 2010; Cohen et al. 2008).

Some authors suggest that feeling states differ from preference, attitudes, and evaluation (Cohen et al. 2008; Derbaix and Pham 1989), and that attitudes primarily serve the function of knowledge (Argyriou and Melewar 2011). However, attitudes are viewed as an affective process that is formed contextually according to consumers' goals, presentation characteristics, and transient affective states (Argyriou and Melewar 2011). Because the affective system is activated by environmental stimuli and driven by affective states (Cappelletti, Güth, and Ploner 2011), in this paper, attitudes are considered to be part of the affective dimension. Attitude can have an effect on the use of credit. For example, it appears that people having a positive attitude to credit are more likely to hold an outstanding credit card balance (Kim and DeVaney 2001).

Behaviors

The behavioral dimension includes all expected behaviors present among competent individuals. Because expected behaviors are different across domains, we will only describe those of competent credit-product users. The Task Force on Financial Literacy (2010) in Canada defines responsible financial decisions as the capacity of individuals to use of their acquired knowledge, skills, and self-confidence to make appropriate decisions in regard to their situations. Decisions made include the reasons for using credit, the choice of credit products, and the way to reimburse the debt.

In most cases, consumers decide if they are going to use credit or savings to obtain what they want. They will compare advantages and disadvantages of spending money now or later (Organisation for Economic Co-operation and Development 2005). However, some people will sometimes make impulse purchases even if they do not have the money, which often leads them to use credit (Kempson 2009; Livingstone and Lunt 1992; Norvilitis et al. 2006; Roberts and Jones 2001). When paying with credit, some people are less concerned with the price and buy more than if they had used another means of payment (Roberts and Jones 2001). It is possible to evaluate the competence of credit use on the basis of the reasons for using it. For example, a person using a credit card to spoil himself or herself may be considered less competent than a person using credit to buy durable goods, such as a refrigerator (Mae 2009).

A competent user of credit products will evaluate the advantages and the costs of each means of payment and will look for the better interest rate (Autorité des marchés financiers 2012;

Organisation for Economic Co-operation and Development 2005). Also, it is better to possess fewer credit cards (Chen and Huang 2011; Norvilitis et al. 2006; Roberts and Jones 2001) and to have a lower credit line (Chen and Huang 2011).

The way individuals reimburse their loans is a good indicator of their level of competence. Expected behaviors here will be to pay off credit cards at the end of each month, to never miss a payment, to reimburse the total amount on time and to understand the link between payment performance and credit history (Autorité des marchés financiers 2012; Kempson 2009; Organisation for Economic Co-operation and Development 2005; Roberts and Jones 2001). In comparison, individuals who frequently use the credit available on one card to make a payment on another and often make the minimum payment on credit card bills can be considered less competent consumers (Roberts and Jones 2001).

One of the objectives of having competent behaviors is to avoid indebtedness. People who verify their capacity to reimburse a loan even if there is an increase in interest rates, who are aware of the costs of cash advances on credit cards, who rarely go over their available credit limit and who use savings rather than credit to buy things are less likely to accumulate debt (Autorité des marchés financiers 2012; Kempson 2009; Roberts and Jones 2001).

Conclusion

This paper aimed to present an exhaustive definition of competence in consumer credit products. This definition appears as follows: multidimensional concept composed of cognitive, affective, and behavioral dimensions where the consumer adequately uses credit products. It goes one step further by including simultaneously three dimensions instead of only one. For example, the concept of financial numeracy is of interest when determining a consumer's management of his own personal finance (Huhmann and McQuitty 2009). However, it only provides information on his processing ability and his knowledge of a financial concept, i.e., the cognitive dimension. Because competency is defined as multidimensional, it was essential to specify each dimension: cognition, affect, and behavior. By measuring these dimensions simultaneously, practitioners and educators will better know which aspects of competence should be reinforced in the goal of fostering greater financial health. The challenge arising from this detailed definition will be to parsimoniously measure (i.e., using fewer questions) all the dimensions and variables that must be included in order to offer a full and representative portrait of credit product consumers.

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