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Credit Choices: An Examination of Consumer Approval for the Financing of Luxury Items and Education

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As a result of the longest-running economic expansion in history (Russell & Mogelonsky, 2000), American consumers' spending, including their purchases with credit, has been increasing rapidly. Due to the deregulation of the financial industry and lenders' aggressive risk-based marketing practices, 21st century Americans have had unprecedented access to consumer credit. Thus, Americans have been empowered to buy what they want when they want it, without paying in full at the time of purchase.

The "buy now, pay later" nature of credit purchasing enables consumers to acquire expensive luxury products, such as fur coats and jewelry. Consumers with a positive attitude toward using credit for luxury items may have materialistic values and attach importance to their possessions (Belk, 1985). Because possessions can increase individual satisfaction and happiness for materialistic consumers (Fournier & Richins, 1991), such consumers are likely to feel the need to acquire highly visible, expensive products, such as fur coats or jewelry, even though they have to borrow money to finance such purchases.

Consumer credit also may be used for longer-term investments, such as educational expenses. The difference between using credit to purchase luxury products and using it to finance an education is that the former usage is more consumption-oriented, while the latter is more investment-oriented. The commonality is that they both incur long-term financial obligation, or consumer debt.

Although the growth of consumer credit has contributed to the expansion of the U. S. economy and raised the quality of life for millions of American consumers, it also has brought about extensive consumer debt. According to Durkin (2000), total consumer credit debt in June 2000 was $1,456 billion, an approximately 1,200% increase from $119 billion in 1968. Household bankruptcy filing rates are also on the rise; personal bankruptcy filings exceeded $1 million in 1996 (National Bankruptcy Review Commission, 1997), reaching $1,281,581 in 1999 (Lawless, 2000).

Why are so many consumers having financial difficulties in spite of their growing wealth in general? Often, financial institutions are criticized for their indiscriminate marketing practices of offering credit to even young, low-income consumers who are not able to pay their balances. However, a fundamental problem may be consumers' propensity to spend and to use credit to satisfy their imminent consumption desires. Consumers' materialistic values and tendency to use credit for purchases that otherwise they could not afford leads to consumer indebtedness.

The rising consumer debt levels are not necessarily problematic if incomes also are expected to rise in the long run (Schmitt, 2000). For example, college education is costly, but it is still believed to be a worthwhile investment because it enables individuals to acquire higher future earning potential. In contrast, using credit for the purchase of luxury items may reflect individuals' propensity to overspend. Spending beyond their means likely will have a negative effect on consumers' financial future, especially since credit card debt often involves high interest rates, with some up to 21.99%.

Purpose

The purpose of this investigation was to examine how consumers' approval of credit usage for two different types of purchases was related to their levels of indebtedness. Specifically, we examined consumers' approval of credit usage to finance luxury products such as a fur coat and jewelry, and to finance educational expenses. In addition, a profile of consumers was compiled (i.e., age,

income, education, and gender) based on their approval of credit usage.

Methods

The study employed the 1998 Survey of Consumer Finances (SCF). The SCF is a triennial survey sponsored by the Federal Reserve Board with the cooperation of the Statistics of Home Division of the Internal Revenue Service (Kennickell, 2000). It was designed to provide detailed information on U. S. families' balance sheets, their use of financial services, and demographic data. For the 1998 SCF, members of 4,309 households were interviewed, providing comprehensive information about each household's finances. For the current study, the following variables were selected: approval of credit use for selected purchases, number of credit cards, credit card debt excluding real estate-related loans, loan turndown or reduction history, and demographic characteristics.

Approval of credit use for luxury items. The following item was used to measure respondents' approval of credit use to finance luxury products: "People have many different reasons for borrowing money, which they pay back over a period of time... Please tell me whether you feel it is all right for someone like yourself to borrow money to finance a fur coat or jewelry." For this item, a positive (yes) or negative response (no) was recorded.

Approval of credit use for education. Responses to the following item measured respondents' approval of credit use to finance educational expenses: "Please tell me whether you feel it is all right for someone like yourself to borrow money to finance educational expenses." Again, a positive (yes) or negative response (no) was recorded.

Number of credit cards. The total number of credit cards for each respondent was reported. This included cards issued by banks (e.g., VISA, MasterCard, Discover, Optima), retail stores and chains (e.g., Sears, Macy's), gasoline companies (e.g., Shell, Exxon, Texaco), and travel and entertainment card companies (e.g., American Express, Diners Club).

Credit card debt. Consumers who had outstanding balances following the previous month's payment were considered to have credit card debt. To estimate total debt from the types of credit cards listed above, all outstanding balances following the previous month's payment were summed to reflect a household's credit card debt.

Total debt excluding real estate-related loans. A composite measure that reflected each household's total debt, excluding real estate-related loans such as mortgage and land contracts, was created. Total debt included credit card debt, installment loans, and other miscellaneous loans.

Loan turndown or reduction history. This variable reflected whether the respondent had been turned down for a loan application or was offered a smaller loan than that for which they had applied.

Demographic characteristics. Demographic information regarding the respondent's age, education, and income was recorded.

Data Analyses

In order to compare the two groups of consumers, those who approved of credit use for specific purchases (luxury items and education) and those who disapproved, analysis of variance (ANOVA) and Chi-square analysis were used. Specifically, ANOVA and resulting F values were used to examine the differences in number of credit cards, total credit card debt, total debt excluding real estate-related debt, and income. Chi-square analysis was utilized to investigate the group differences in the percentage of consumers who had credit card debt and the percentage of consumers who had the experience of being turned down for a loan or were offered a reduced loan amount.

Results

Over 80% of consumers responded that it is all right to borrow money to finance educational expenses, whereas only 5.5% of consumers approved of using credit to finance the purchase of a fur coat or jewelry. There were no differences in age, education, or income for consumers who approved of credit use for either luxury products or educational expenses. In general, consumers who approved of borrowing money for either purpose were likely to be younger, more highly educated, and earn more income relative to those with negative attitudes toward credit.

Credit Use for Luxury Items

Consumers who approved of using credit for luxury items had more credit cards (mean = 4.96) than those who disapproved of charging luxury items (mean = 3.44), $F(1, 4,307) = 45.95$, $p < 0.0001$) (see Table 1). Additionally, there was a difference in the percentage of consumers who had credit card debt based on their approval of the use of credit to finance luxury items, $\chi^2(1, 4,309) = 24.96$, $p < 0.0001$ (see Table 2). Yet, there were no differences in the incomes of consumers who approved of borrowing money for luxury purchases and those who disapproved of such credit use, $F(1, 4,307) = 1.27$, $p = 0.26$) (Table 1).

Sixty-three percent of the consumers who approved of using credit to finance luxury items had credit card debt, whereas only 43% of those who disapproved of using credit for such purchases had credit card debt. Furthermore, consumers who approved of credit use for luxury items also tended to carry a greater amount of credit card debt (mean = $3,054) compared with consumers who disapproved of such credit use (mean = $1,744), $F(1, 4,307) = 19.60$, $p < 0.0001$) (see Table 1). A significantly larger percentage of consumers who approved of credit use for luxury items had been denied a loan or offered a smaller one (32%) compared with the percentage of consumers who disapproved (21%), $\chi^2(1, 4{,}309) = 13.40$, $p < 0.001$ (see Table 3). No differences in total debt excluding real estate-related loans were observed between consumers who approved of using credit for luxury purchases and consumers who did not, $F(1, 4{,}307) = 3.64$, $p = 0.06$ (Table 1).

Table 1
Number of Credit Cards, Total Credit Card Debt, Total Debt, and Income by Approval Variables: ANOVA Results

	Mean No. of Credit Cards	Mean Total Credit Card Debt	Mean Total Debt (excl. Real Estate)	Mean Income
Approval of Credit Use for Luxury Items[a]				
positive (yes)	4.96	$3,054	$12,835	$65,849
negative (no)	3.44	$1,744	$9,750	$51,501
F	45.95*	19.60*	3.64	1.27
Approval of Credit Use for Education[b]				
positive (yes)	3.20	$1,914	$10,622	$54,860
negative (no)	2.79	$1,414	$6,847	$41,666
F	16.53*	1.12	0.02	0.67

[a]n = 4,307. [b]n = 4,307
*$p < 0.0001$

Credit Use for Education

Consumers who approved of borrowing money to finance educational expenses also had more credit cards (mean = 3.20) compared with consumers who did not (mean = 2.79), $F(1, 4{,}307) = 16.53$, $p < 0.0001$ (see Table 1). Forty seven percent of consumers who approved of credit use for educational expenses had credit card debt, whereas only 32% of those who did not approve of such credit use had credit card debt, $\chi^2(1, 4{,}307) = 57.68$, $p < 0.0001$ (see Table 2). A higher percentage of consumers who approved of borrowing money for education had been denied a loan or were offered a smaller one, compared with consumers who disapproved of borrowing money for education, $\chi^2(1, 4{,}307) = 57.69$, $p < 0.0001$ (see Table 3). There were no differences between consumers who approved of credit use for financing education and those who did not in terms of the average amount of credit card debt, $F(1, 4{,}307) = 1.12$, $p = 0.29$), or total debt excluding real estate-related loans, $F(1, 4{,}307) = 0.02$, $p = 0.89$ (see Table 1).

Table 2
Chi-Square Analysis of Retention of Credit Card Debt (CCD) by Approval Variables

Variable	N	% with CCD	χ^2	df
Approval of Credit Use for Luxury Items	4,309		24.96*	
positive (yes)		63		1
negative (no)		43		
Approval of Credit Use for Education	4,309		57.68*	1
positive (yes)		47		
negative (no)		32		

*$p < 0.0001$

Discussion and Implications

The results of this study showed that consumers who approved of using credit for luxury purchases had more credit cards and greater credit card debt than consumers who disapproved of using credit for such purchases. By contrast, there was no difference in debt for those consumers who approved or disapproved of borrowing money for education.

Table 3
Chi-Square Analysis of Experience of Loan Turndown (LT) or Reduction (R) by Approval Variables

Variable	N	% LT/R	χ^2	df
Approval of Credit Use for Luxury Items				
positive (yes)	4,309		13.40*1	
negative (no)		32		
		21		
Approval of Credit Use for Education				
positive (yes)	4,309		57.69**	1
negative (no)		24		
		11		

*$p < 0.001$. **$p < .0001$.

There were no differences in the incomes of those who thought it was all right to charge luxury purchases and those who disapproved of such credit use. This suggests that although consumers who approved of using credit for the purchase of luxury products did not earn significantly more money, they believed it was alright to spend more. Consequently, their credit card debt was higher than those who disapproved of using credit to finance luxury items. The more conservative attitude about charging luxury items was reflected in the frugal use of credit by those who disapproved of using credit to purchase such items.

This study demonstrated that consumers' approval of the use of credit for luxury purchases is an important indicator of their level of indebtedness. Consumer educators should inform consumers that their approval of credit use for luxury purchases could have detrimental effects on family finances. Materialism may become a problem in situations where consumers acquire highly expensive products on credit, thus placing a serious financial burden on their households. In cases where consumer debt is incurred through

luxurious consumption, consumer educators should discourage consumers from using credit to satisfy imminent materialistic desires. It is recommended that consumers in financial trouble adopt a more frugal lifestyle and use credit more judiciously, since credit card debt combined with other financial obligations can lead to spiraling problems with creditors.

The costs for higher education have been rising at a rate greater than inflation in recent years. Education costs will likely continue to rise over the next several years and thus consumer demand for educational loans are expected to escalate. Importantly, it should be noted that student loans are offered at a much lower rate than most credit card loans. In addition, current tax laws allow a tax deduction for student loan interest (Milam & Olach, 2002). The results of this study demonstrated that consumers who approved of borrowing money for educational purposes did not necessarily incur higher debts (including credit card debts and total debts) than those who disapproved. Since higher education significantly enhances future earning potential, borrowing money for educational purposes can be viewed as an investment.

In sum, the consumer credit choice for purchasing luxury items, not for financing education, is likely to lead to significantly higher consumer debt. "Learn now and pay later" is a reasonable credit choice for most consumers; "buy luxury now and pay later" is not.

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