

What Explains Credit Card Delinquency: Mental Accounts or Rational Financial Planning?

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Abstract

This study proposes a model of credit card delinquency based on advances in mental accounting. Using a comprehensive dataset combining credit and debit transactions, three hypotheses are supported. First, higher payment decoupling increases probability of delinquency, when continued borrowing is promoted by reduced salience of past expenses. Second, behavior consistent with decision-making ineptitude also increases probability of delinquency; some cardholders habitually spend in excess. Third, a lower concern for future consequences also increases probability of delinquency; present-biased individuals discount future repayments at a higher rate. The proposed model approximates behavior realistically, while inspecting the validity of the theoretical concepts.