

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

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Abstract

This study proposes a model of credit card customer delinquency based on advances in mental accounting. Using a comprehensive dataset combining credit and debit transactions, the following three hypotheses are supported. First, increased payment decoupling leads to a higher probability of delinquency, when continued borrowing is promoted by reduced salience of past expenses. Second, the results show that behavior consistent with decision-making ineptitude also increases the probability of delinquency. Some cardholders habitually spend in excess, refusing to accommodate consumption to a financially reasonable level. Third, a lower concern for future consequences also increases the probability of delinquency. Present-biased individuals discount future credit card repayments at a higher rate and consistently spend at perilously high rates. The proposed model allows for more realistic approximation of behavior, while simultaneously inspecting the validity of the theoretical concepts.

Keywords: *Mental accounting; credit cards; hierarchical Bayesian logit*

Track: Methods, Modelling & Marketing Analytics