



## The Impact of Credit Card Rewards on Consumer Borrowing (With reference to Patna district)

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**Abstract** : Credit card reward programs are marketing programs that cultivate an ongoing relationship between a provider of goods or services and customers. Reward programs focus on the holy trioka in marketing; recency, frequency, and money—known in marketing circles as “RFM.” **Rewards programs create incentives that help retailers capture and maintain customers** and also help retailers share some of the intangible value of market share with regular customers.

The substitution of cash by card (and other electronic) payments represent one of the main goals of both economic planners and financial industry participants since this transition may imply significant private and social benefits.

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**From a card issuer perspective, the main strategic way to promote the use of cards has been through offering rewards programs.** However, little is known on the effectiveness of these programs in promoting card usage relative to paper-based payment instruments. This article offers novel evidence on the impact of credit card rewards on the general preferences for the use of cards relative to cash.

To undertake this analysis, we performed several empirical tests using a unique survey of consumers' preferences for payment instruments in Patna. We isolated the effect of rewards from the usual set of demographic and behavioral variables employed in most previous studies. **As far as the demographic and behavioral characteristics are concerned, our results are mostly in line with the existing literature.** However, we show that rewards programs can also significantly affect the preferences for cards relative to cash payments. Our results may have important implications for both policymakers and card issuers. The former will have to have a closer look at the structure of incentives in the payment industry and the path of substitution of cash by card payments assigning proper weights to demographic, business and behavioral factors to accurately develop new policies to increase the rate of substitution of cash by cards which, in many countries, is being slower than expected. At the same time, the large expenses that card issuers undertake on incentive programs need to be confronted with the effectiveness of the different rewards programs on card usage (relative to cash) across merchant activities. Therefore, more research is needed on the evaluation of the effectiveness of rewards programs and on the proper way to stimulate card payments both from the public and the private side.

**Keywords:** Credit cards, reward programs, incentives.

## Introduction:

Credit card reward program is an incentive program operated by credit card companies where a percentage of the amount spent is paid back to the card holder. VIP perks that come with travel and entertainment (T&E) programs are good examples. These perks offer consumers a cachet that exceeds the actual financial reward; for example, access to a members' lounge at an airport once a certain status level has been achieved. From a business perspective, increased or retained market share and strong and sustained customer loyalty may offer a market valuation far greater than that dictated by current earnings alone. Today, rewards are routinely given by airlines, hotel operators, and credit card issuers to increase use of their products. In case of credit cards, rewards are an effective way to attract card holders or convince existing ones to use a specific card for their purchases and borrowing needs (Agarwal et al. web). Credit card companies have pursued aggressive tactics, such as offering cash back airlines miles, rebates and lower interest rates in order to steal and retain customers, thus ensuring a greater market for itself. The main objective of the card companies is to increase card spending that may result in cardholder's debt in the future. While the reasons as to why credit card companies decide to implement reward programs might to some extent differ between firms it is likely that adoption of rewards programs is, partly, a result of the firms' battles against competitive parity in a fiercely competitive industry.

## Objectives:

- To study the impact of credit card rewards on spending and debt of consumers.
- To analyze consumer's response towards credit card reward programs.
- To find answers for the following questions:

1. Do consumers spend more when given rewards?
2. Do consumers accumulate debt on their cards because of these rewards?

## Hypotheses :

- Reward programs may significantly affect the use of cards relative to other payment instruments.
- The effects of these reward programs may vary on the types of incentive applied.
- Certain types of card holders are more responsive to the cash back programs. Card holders that do not carry debt are more responsive to the cash back programs.
- Specifically, inactive card holders increase their average per month spending.

## Methodology:

The study is based on empirical research based on survey method. In an attempt to increase precision in respondents' answers, we chose to utilize a visual analogue scale (VAS) in the present study. The VAS-scale consists of a ten centimeter, straight line anchored by continuums such as "Unappealing to me" on one end and "Highly appealing to me" on the other. Each respondent is subjected to a question or statement and then asked to put an X in the linear spectrum that they believe they fit. Each answer was then measured with a ruler, resulting in a high precision answer between 1 and 100, as opposed to those answers entered in to a 7-point like scale where there are only 7 options for the respondent to choose between.

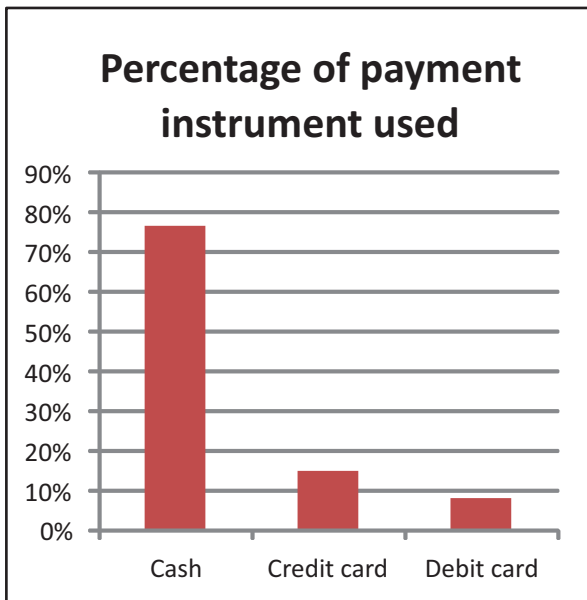
By utilizing Sullivan's systematic sampling technique in order to retrieve a truly random sample, every 5th person passing by was approached (Sullivan, 1994, p. 1297). In total, 367 persons were asked to participate in the research

and 300 of them agreed to complete the questionnaire. This resulted in a response rate of 81.74%, however 17 of the respondents had not entered their answers in a measurable manner and could thus not be included in the study while another 90 did not have credit cards. The final survey sample thus consisted of 201 respondents.

The survey was conducted in malls of Patna district namely Big Bazaar, Reliance Trends and Vishal Mega Mart and the statistical data was collected from several banks. Further, in order to gain a comprehensive data mean or average was calculated and stated.

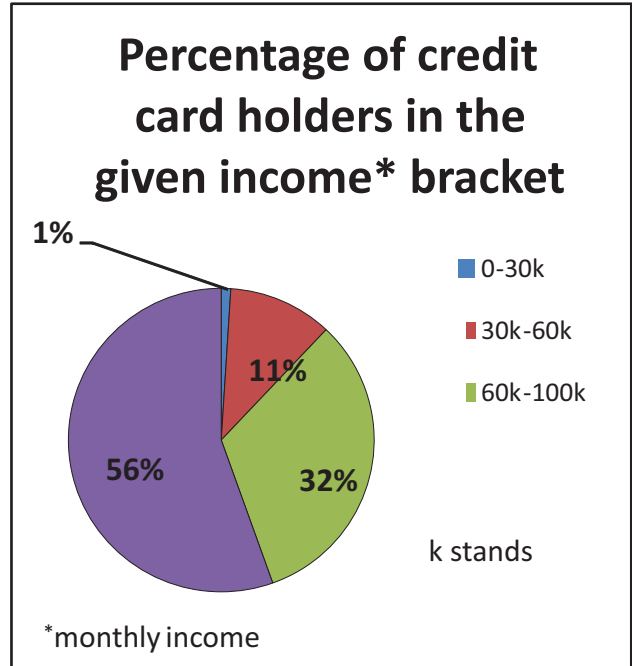
**Research findings :**

The survey conducted by us revealed that cash was used by 77% of the respondents to make daily purchases while credit card was used by 15% and debit cards were used by 8%. Debit cards are generally used to take out cash from ATM. The low level of payments made by electronic transaction is due to low availability of POS in Patna.

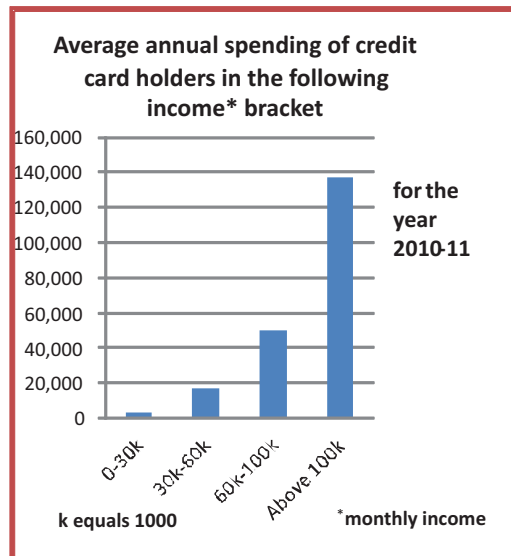


56 % of credit card users belong to the monthly income group of above one lac while 32% of the credit card users fall into the monthly income range of 60,000–10,00,000. 49% of card holders belonging to the monthly income group of above

1,00,000 who actively use their credit cards in comparison to a meager 6% of those belonging to the income group of 0-30,000 .This result validates

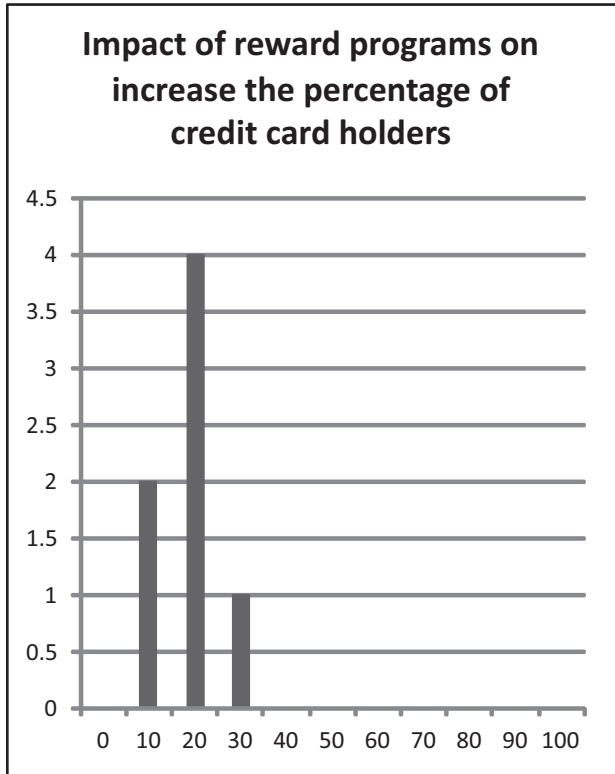


our general understanding that people belonging to the more affluent income groups spend more lavishly as their purchasing power is relatively higher and they prefer more easy and convenient payment instrument, albeit credit cards.



We find that credit card holders earning above 1,00,000 per month are the prolific users with their

average annual spending above 1,30,000. Contrary to the above fact are the credit card holders belonging to the income bracket of 0–30,000 with their negligible annual spending of about 30,000.



As per the data collected, almost all the banks voted against the positive impact of rewards on the increase in the percentage of credit card holders as we can see that almost all banks have voted between the scales of (10-30). One possible reason for the above response could be inconvenient constraints functioning against positive impact. These constraints could be the normal application process, 15-day processing time, time restraint cash-back/ reward schemes.

Consumers' response to card rewards vary and are dependent on various constraints, an important one being debt accumulation on cards. We believe that 'revolvers' people who carry/revolve debt from one month to another are reluctant in responding to rewards, as it may further increase their debt, thus leading to a huge interest repayment. Inactive/ dormant card holders are more responsive in increasing their average per month spending.

Majority of survey participants (50.6%) did not have any credit card validating the fact that India still has very low penetration of electronic mode of payment and 35.6% possessed one credit card. Those who possessed two and three credit cards accounted for 12% and 1.6% respectively.

Some credit card holders were loyal consumers, unwilling to change their credit card company (or bank) despite having the option availing better rewards.

### Conclusion:

Reward programs are an effective way for the credit card companies to entice customers. Usage and demand of a particular card depends on the incentives it has to offer. Consumers are becoming more aware of the benefits of credit cards and there is a strong inclination towards credit cards. Over the past decade, there has been a significant increase in the percentage of credit card holders. The average monthly spending on these cards has also increased. It would be realistic to assume that because of this kind of consumer behavior, card companies will aggressively compete to bring out innovative and effective credit cards that extensively target the needs of the consumers, thus making extreme efforts to capture target market.

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