The ethical and policy implications of profiling ‘vulnerable’ customers

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Abstract
In the shadow of the global financial crisis, the issue of the marketing of credit has become an increasing concern in the past 12 months. Outstanding personal debt in the UK currently stands at £1479 billion and is rising by £1 million every 10.6 min. In Australia, there is currently $44.6 billion worth of outstanding credit card debt, and in the US, $2596 billion was owed on credit cards in 2008. At present, the banking sector utilizes sophisticated research methods to profile consumers, including those who might be considered financially vulnerable. However, the policy frameworks in most industrialized countries do not account for this form of target marketing when considering how to protect vulnerable groups. This paper is an initial attempt to examine the different methods by which profiling is conducted and the policy implications of this sophisticated form of segmentation and targeting. We argue that current consumer policies are inadequate in protecting vulnerable consumers from these marketing techniques, and recent recommendations from the Federal Reserve Bank of the United States, and the Australian Law Reform Commission to allow banks and lenders to ‘pre-screen’ potential customers will exacerbate personal debt levels, rather than reducing them.

Introduction
Since 1990, the consumer sector has emerged as the dominant user of bank loans (Jain and Bennett, 2006). Household debt in Australia has tripled since 1990 and accounts for around 150% of households’ disposable income. In the United States, $2596 billion was owed in consumer credit in December 2008 (Federal Reserve Statistical Release, 2009). The current average household debt in the UK is £9550, which increases to £21 766 if the average is based on households that have some kind of unsecured loan (Talbot, 2009). The London School of Economics is calling these trends 'The First World Debt Crisis of 2007–2010', noting that the United States’ sub-prime crisis is symptomatic of a global financial crisis (Wade, 2008). Sanchez (2009, p. 1) describes the rise of consumer debt and bankruptcy as ‘explosive’ over the last 20 years of the American economy.

It is worth noting that the rise in consumer debt has slowed in the last 12 months, especially in the first quarter of 2009. In the United States, the fourth quarter of 2008 showed a decrease in consumer debt at an annual rate of 3%. This followed a pattern of decrease that emerged in 2008. However, this decrease comes on the heels of steady increases in revolving credit of 5% per annum for the period 2004–2007 (Federal Reserve Statistical Release, 2009). A trend of decrease in the UK has similarly occurred in 2008 with personal debt at a growth rate of 3.6% per annum. However, outstanding personal debt is currently £1479 billion and rising by £1 million every 10.6 min (Talbot, 2009). This steady rise in consumer debt has occurred at the same time that the banking sector has increasingly taken to using sophisticated marketing research methods, including the use of profiling, neural-networks, classification and regression trees, and predictive modelling to target customers more efficiently and effectively (Copeland, 2000; Lee et al., 2002; Christiansen, 2008).

Sanchez (2009) found that there was a positive correlation between the rise of consumer debt and financial institutions’ access to information. The conclusion of the study was that ‘the drop in information costs alone explains 37 per cent of the rise in the bankruptcy rate between the years 1983 and 2004’ (Sanchez, 2009, p. 4). This study examined the effects of screening processes (i.e. the rise in debt-to-income and bankruptcy), rather than the practice of screening. Sanchez did identify, however, that these screening processes, and the ‘cost of information’, are linked to the development of new technologies.

Background
Like other businesses, the banking sector utilizes sophisticated research methods to segment and target consumers; however, in this sector, these research technologies are also targeting consumers who they refer to as ‘profitable’, but others would call financially vulnerable (Stone, 2008). These strategies involve practices such as buying personal credit information from specialist
companies and targeting those considered to be in financial ‘need’ (e.g. at the upper end of their credit limit), and therefore more susceptible to accepting a loan or credit card to alleviate their immediate problems. Accessing this kind of information allows lenders to segment groups of potential customers, and tailor marketing strategies to them (Dibb et al., 2002).

For ‘vulnerable’ consumers, these offers can appear to serendipitously come at just the right time. What may not be apparent to these consumers is that they have been deliberately targeted using extensive and sophisticated marketing strategies by lenders. Although segmentation in marketing is not new, we argue that it is no longer appropriate for business and government to simply partition off marketing strategies from their wider social, economic and political implications. Further, we suggest that the entire policy framework in relation to credit marketing needs to be reconsidered in light of the sophisticated modelling now available to banks and finance companies.

This paper is an initial attempt to examine the different methods by which profiling is conducted, and consider the policy implications of this sophisticated form of segmentation and target marketing. In this context, our methodology follows an approach similar to that in a legal investigation, by considering circumstantial evidence, establishing intent and examining effect. Through a review of academic papers related to finance, marketing and management systems industry, as well as financial and business magazines and newspapers, this research establishes a ‘case for consideration’, and suggests future research directions for both marketing practice and government policy.

The reasons for exploring the impact of these strategies and why consumers, marketers and policy makers might be better informed are manifold: the substantial rise in consumer debt; an overall decrease in domestic households’ savings; the influence of personal debt in relation to the global financial crisis; and predictions of a substantial rise in unemployment which will impact upon the spending capacity of the population. In turn, all of these factors have the capability to significantly influence economic, social and political development, and therefore should be of concern to marketers specifically, and the business world, more broadly.

Profiling vulnerable (and profitable) customers

Subsegmenting is where the gold is.

– Larry Seldon, Professor Emeritus of finance and economics at Columbia Business School (Dragoon, 2006, p. 2)

The plethora of research into data mining in the finance industry in the last decade reflects the shift in banks’ focus from using data to assess risk, to utilizing technologies to better target customers (Bailor, 2007). Information technology magazines advise the finance industry, ‘one of the more powerful techniques for discovering ways to increase sales and revenue is to use data mining and analysis tools to perform customer-segmentation studies. Such studies can be an effective way to learn about emerging sales-channel problems to find unmet market needs that instantly translate into new sales opportunities’ (Pallatto, 2003, p. 12).

Two areas emerge in this research of particular interest in the finance sector: credit scoring and behavioural modelling [e.g. choice-modelling profiles built through mining transaction records (Cohen, 2004)]. The combination of these two analytical tools has enabled lenders to build modelling programmes that predict choices that consumers are likely to make, and their likely financial habits. Credit scoring is employed by the finance industry to assess a consumer’s profitability as a credit customer. Some models of credit scoring examine repayment ability of the customer, outstanding debt (which is weighted as a positive criteria in many models) or the frequency of the repayments from the customer (Hsieh, 2004). Other models assess the risk level of the credit card applicant and the likelihood of default during a period of time (Mavri et al., 2008). Advanced computational systems for data mining such as neural networks, classification and regression trees, and multivariate adaptive regression splines are increasingly being employed (Lee et al., 2002; Malhotra and Malhotra, 2003).

Data mining has drawn serious attention from both researchers and practitioners because of its ‘wide applications in crucial business decisions (Lee et al., 2002, p. 1114)’. Neural networks are computer systems whose architecture is inspired by the functioning of the human brain. These systems are flexible, non-linear modelling tools, which are comprised of several ‘layers’ which segment and subsegment information into ‘nodes’ (Zhang et al., 1999, p. 17). Neural network systems are increasingly being employed to process the large quantities of data in the finance industry (Agrawal et al., 1993).

In promotional literature, customer analytics and customer relationship management software providers emphasize the need that ‘business-to-consumer enterprises have to build better and more profitable relationships with their customers in a customer-centric economy’ (Danna and Gandy, 2002, p. 374). On the surface, the focus on customer relationship management, i.e. tailoring products to specific customers’ needs, is in consumers’ interests. Indeed, it is arguable that consumers can be better protected from making poor financial decisions that may lead to unmanageable debt or bankruptcy (Malhotra and Malhotra, 2003). However, the language employed not only by industry, but also by academic research in fields such as systems technology, suggests a different focus.

Lenders argue that these behavioural models are being used to predict consumers’ probability of default or bankruptcy (Zhang et al., 1999). This may well be in the best interests of both the bank and the customer. If the bank can determine that a customer is likely to default given a higher loan and/or credit, then the bank might well prevent that person from making a financial decision that will affect them adversely. In this sense, the profiling and data mining performed by the finance industry can be viewed as benign and benefiting both parties.

While the risk for the customer and the bank is worthy of assessment, it can also be argued that lenders are using this information to assess the profitability of the client (Hsieh, 2004). An analysis of commissioned research, academic papers, finance and marketing magazines, and newspapers suggest that banks are concerned with the needs of consumers insofar as it contributes to organizational performance, and ultimately financial viability and return to shareholders (Tillett, 2000; Berger and Wharton Financial Institutions Centre, 2003; Pallatto, 2003; Cohen, 2004; Dragoon, 2006; Bailor, 2007; Radonić and Ćurko, 2007; Griffiths, 2007). While profit generation and (a broad definition of) consumer needs may not be mutually exclusive, they should not necessarily be assumed to be reliant upon one another.
Consumers, from whom the industry stands to make financial gains, are routinely referred to as ‘profitable’ customers (Hallowell, 1996; Hsieh, 2004). Martin Lippert, vice chairman and CIO at RBC Financial Group, for example, says, ‘Our opportunity lies in finding what the needs of the customer might be so we can offer them additional products and get them to a point where we’re making some return’ (Dragoon, 2006). Consumers are explicitly referred to as profitable when the bank stands to make higher short-term gains from them (Tillett, 2000). Indeed, banks are so focused on their interest yielding customers, that they effectively punish those who are in greater control of their finances, e.g. customers who apply for credit limit increases are considered a higher risk, than those who receive an unsolicited limit increase offer from the bank (Harrison and Massi, 2008).

Rob DeSisto, an analyst for the Gartner Group (who ‘drive future growth by monetizing business intelligence and customer data’) (Gartner Group, 2009) says, ‘If a customer is not a profitable one you would want to charge them higher fees than those customers that are profitable’ (Tillett, 2000, p. 45). This underscores the shift by banks from seeing the profitability of those customers who are managing their debt effectively coming from ongoing account fees, to a customer who struggles to maintain their debt but yields short-term gains in high interest.

Publications in academic journals use similar language, noting that profiling is ‘essential to enterprises to successfully acquire new customers and retain high value customers’ (Hsieh, 2004, p. 623). However, what defines a high value customer in the models presented in these journals is a customer who may be struggling to repay debt, or at the upper end of their borrowing capacity, but is consistently generating income for the lender from interest (Tillett, 2000; Derringer, 2006; Morgenson, 2008; Moyer and Shumsky, 2008; Stone, 2008). Data mining is tied to customer relationship management systems ‘to help better understand [. . .] customers’ (Tillett, 2000, p. 45).

Marketing magazines (trade magazines, as opposed to academic journals) tell us that financial institutions are using profiling information to generate, ‘. . . tactical Models – such as the propensity to buy, the likelihood of a customer cancelling a product or service, and the degree to which a customer uses the products he’s acquired’ (Dragoon, 2006). Tactical modelling, behavioural modelling and variations of choice modelling are all similar applications of profiling data (Hsieh, 2004). Advanced technologies used for profiling are giving banks and lenders far greater and more detailed information about consumers’ behaviour and likely choices than ever before. Both academic sources in data mining and systems technology, and marketing magazines speak to the benefits of profiling to increase sales and financial gains for lenders (Macintyre, 1999; Tillett, 2000; Pallatto, 2003; Cohen, 2004; Dragoon, 2006; Bailor, 2007; Curko et al., 2007; Williams, 2007; Cruz-George, 2008; Mavri et al., 2008).

Current policy frameworks

In the context of credit marketing and profiling, there are several reasons for consumers’ inability to defend themselves against the marketing practices of the lending institution. Recent research from the Office of Fair Trading (2008) in the UK, for example, found that 70% of consumers did not shop around for the best credit card deal for themselves, and that 30% of consumers simply took the deal that was suggested by their financial institution, trusting that their lender would look after their interests. Similarly, other research suggests that customers tend to take a limited interest in financial services and consider them as a necessity (Beckett et al., 2000; Aldlanigan and Buttle, 2001), and are likely to respond positively to suggested products when offered to them. It is arguable, then, that a rational and methodical search for information does not shape and direct rational choice in the financial context, but other exogenous factors influence the consumer’s disposition to purchase financial products (Beckett et al., 2000).

Much policy on consumer credit, however, rarely takes into account this knowledge, assuming that consumers are entirely rational, and will make the best decision for themselves after investigating the seemingly abundant information available. In Australia, for example, elements of psychology and behavioural economics have not been considered in legislation around consumer policy, predominantly because policy makers believe that ‘much policy is already based on, or implicitly accounts for, behavioural economic tenets’ (Australian Government, 2008, p. 309). The obligation to disclose information is at the core of consumer regulation, based on the belief that it ‘enhances consumers’ ability to assess financial products and make informed decisions’ (Australian Treasury, 1999, p. 23). The key consumer protection provisions that relate to advertising and marketing are prohibitions on ‘conduct that is misleading or deceptive, or is likely to mislead or deceive’ (Trade Practices Act, 1974).

In the UK, there is some regulation of information that must be conveyed by lenders (such as account fees and interest charged); however, much of it is based on a rational interpretation of decision-making, and is compromised because of the ‘noise’ created by an overabundance of unnecessary or confusing information (Better Regulation Executive and National Consumer Council, 2007). The Office of Fair Trading (2008) in the UK found that 68% of customers did not compare their current credit card with any others; it was found that it cannot be assumed that consumers will choose the correct product for their needs based on careful research. In the United States, regulations are comparatively more relaxed, allowing lenders to contact consumers unprompted with offers and information (Board of Governors of the Federal Reserve System, 2004). While the Federal Reserve acknowledges that there are undoubtedly situations when prescreened offers result in debt, it argues that these are anomalies; consumers, for the most part, make educated, rational decisions.

In the past, the interests of banks and consumers were not incompatible, and the arguments presented in the report to Congress would have made a certain amount of sense. Lenders have been traditionally interested in clients who remain in control of their debt (Morgenson, 2008; Story, 2008; Craig, 2009). These clients represented long-term investments, and earnings could be made in the form of account fees. Lenders, therefore, had a vested interest in helping these consumers manage their debt so that they would remain an ongoing customer and would provide continual (if small) fees. However, in recent years there has been a shift in focus for lenders. Although it is difficult to locate official sources citing this shift in focus (on the part of lending institutions), recurrent anecdotal evidence continues to surface.

Newspaper articles note that for baby boomers, lenders were highly concerned with a customer’s ability to comfortably manage debt. These articles are highlighting a shift for the current
generation to offering far higher loans and credit in relation to income (Davies, 2008; Morgenson, 2008; Story, 2008; Craig, 2009). Those consumers, that is Generation Y’s parents, who were once the staples of financial institutions have become marginalized as lenders focus on those who provide short-term high yields from debt-generated interest (Morgenson, 2008).

Arguably, the changes in informational technologies have underpinned this shift in priorities for lenders (Berger and Wharton Financial Institutions Centre, 2003). Lenders are able to mine vast volumes of information, such as transaction records, shopping behaviours and demographic shifts (Agrawal et al., 1993). This shift in priority from long-term consumer, to short-term high-interest bearing customer, has resulted in a rise in consumer debt, which coincides with the lowered cost of information access and mining (Sanchez, 2009).

We argue that current consumer policies are inadequate in protecting vulnerable consumers from these marketing techniques, and that on many occasions, consumers are making financial decisions that are against their better interests, simply as a result of clever marketing on the part of large, heavily resourced banks, finance companies and other lenders.

**Conclusion**

The rise in debt and bankruptcy in the last 20 years, and the larger context of the global financial crisis, suggest that greater clarity is required about the causes of consumer debt. We argue that there is a concerning circumstantial link between the increase in informed lenders, reduced costs of data and analysis, and consumer debt (Davies, 2008; Office of Fair Trading, 2008; Sanchez, 2009), and this is supported by organizational intent. If banks have shifted away from viewing long-term customers as highly profitable, and are seeking those who will yield high interest in the short term, then the very information that assesses risk for the finance sector potentially also yields information about the consumers who are likely to yield high interest from debt (Tillett, 2000; Derringer, 2006; Davies, 2008; Morgenson, 2008; Stone, 2008; Craig, 2009).

While the US Federal Reserve recommends that ‘prescreening’ or profiling of customers is beneficial to both the bank and consumer for debt prevention (Board of Governors of the Federal Reserve System, 2004), we argue that if banks have greater access to information about a consumer’s credit record and financial history, or able to ‘wash’ customers through credit reporting agencies, they may be in a position where they can be even more aggressive in their direct marketing strategies.

Of course, people need to take responsibility for their actions. Put simply, though, it is not a level playing field. Banks and financial institutions are massively well-resourced organizations that use complex segmentation and marketing strategies to target these profitable customers with deals apparently tailored to their needs. An individual consumer does not have access to the same level of resources. At present, though, consumer regulation relies on a concept of individual responsibility, with no commensurate responsibility on financial institutions beyond information disclosure, and the honest representation, in whatever form, of the offer.

The notion that increased disclosure to consumers, or increased information to marketers, can be argued to be less than ideal based on the aforementioned arguments. We argue that consumer regulation needs to be more ‘biased’ towards the individual, which represents a shift away from rational interpretations of human behaviour. Clearly, this represents a challenge to the ideological apparatus that restrains and justifies much of business and economic practice; however, similar to recent discourse in the legal profession (Blasi and Jost, 2006), this challenge heralds a debate that is long overdue.

**Limitations and future research**

Rather than providing expedient solutions, implications or recommendations, this paper offers a preliminary attempt to ‘catch’ the shape of an overlooked research and public policy issue. For greater clarity and understanding of the segmentation practices of lenders, and how consumers are affected, a far more detailed investigation and review is required. One factor that should be explored further is the psychological distancing effect of credit on consumers’ perception of money and how consumers spend (Khan and Craig-Lees, 2008). Research is not only being conducted into information systems and data mining, but also into technologies that provide greater convenience to the consumer, such as swipeless credit cards (Wang, 2008). Arguably, the convenience of such technologies has the potential to exacerbate the distancing effect already found to exist between credit and cash (and society’s increasing reliance upon the former) (Davies, 2008; Khan and Craig-Lees, 2008).

Similarly, a more thorough examination of legislation in other countries other than those in this study, viz., United States, United Kingdom and Australia, may provide insight into how other jurisdictions manage the control of personal information. Further research into the effectiveness of policy on decision-making in the field of credit would also be valuable.

We argue, however, that lack of research focused on the ethical implications of targeting profitable/vulnerable consumers should not be an excuse for challenging a particular perspective, despite the rationalist paradigm being believed to be reasonable and sensible, in its role as doxa, in the field of business, government, law-making and marketing (Bauman, 2008). Indeed, we argue that it is the responsibility of the academy to challenge any excessive admiration of particular ideologies or doctrines (Armstrong, 2006). The first step then, in this context, is to incorporate the lessons of behavioural research and reconfigured concepts of vulnerability into our research, our advocacy, our policies, and, more broadly, our discourse.

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**References**


