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The Psychology Of Debt

Collecting delinquent debt is fairly well understood as an occupation or financial function, but little is known about the psychology of indebtedness, why some people are chronically late paying their debts, and how most people feel when they get into such financial difficulties. Can a greater understanding of the psychology of debt help improve collections?

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Introduction

Indebtedness is the financial loss of control arising from catastrophe or failure to delay gratification. Delinquent indebtedness produces profound humiliation in most people that results from society's criticism of those who lose such control repeatedly. "I don't like being in debt, and was pleased to have the opportunity to clear it." This statement, from a CFS customer who settled her account in full, exemplifies the psychology of indebtedness. Debt is aversive for most people. To owe another is to relinquish control. Owing money results in loss of independence and becomes the source of much shame and humiliation. People want to extricate themselves from situations associated with blame. Many of our cultural institutions exist to help people regain control and expiate guilt. Schools of law, psychiatry and theology, as well as debt collection companies, provide the practitioners our society depends on to recover control and restore hope.

Eliminating lingering debt is very restorative for most people. To some, it feels like a cancer has been removed. One CFS customer wrote: "None of us want to be treated like deadbeats and most of us truly want to pay our debts". There are many reasons why people repay their obligations and resolve delinquent accounts. Certainly, the restoration of control over one's financial future looms large in people's decisions to pay off debts. The opportunity to clean a negative credit history enables someone to become eligible for new sources of credit. The moral obligation to make good on one's promises is a powerful imperative. Helping a family member climb out of debt and wishing to not leave a legacy of debt to heirs are altruistic reasons often cited for payment.

Indebtedness is, therefore, both a financial and a psychological phenomenon. An individual's motivation to eliminate indebtedness flows from financial means as well as emotional desire. Efficient resolution of debt by those collecting it requires the emotional intelligence to realize that indebtedness is as much a matter of the heart as it is of the wallet. Absence of emotional intelligence in the collection of debt frequently results in disastrous interactions between collector and customer that are not conducive to recovery.

The following discussion of consumer debt and the psychology of indebtedness is an overview of the reasons people become delinquent in their payments, the factors involved in their decision to resolve the delinquency and the emotional intelligence necessary for the successful collection

of debt.

Consumer Debt

Despite the many factors motivating human beings to resolve delinquencies, consumer spending, indebtedness and bankruptcy continue unabated in the United States. In its 1996 publication *October Economic Trends*, the Cleveland office of the Federal Reserve Bank reported that "Over the last 15 years, households have increased the share of their income that they spend by four percentage points- to about 92.5%". Over the same period, the report continues, the ratio of debt to income has increased by about 25 percentage points. While much of this increase is due to the mortgage credit area, the delinquency of credit card debt has risen. In 1990, of all consumer delinquencies (i.e., installment loans and credit card accounts), credit card delinquencies accounted for 2.25% of outstanding loans. By 1996, credit card delinquencies accounted for 3.5% of outstanding loans. Installment loan delinquencies remained steady at between 2% and 2.5% of outstanding loans over the same period. The Federal Reserve Board also reported that revolving debt in the United States had doubled in five years: from \$265 billion in 1992 to \$528 billion in 1997.

The American Bankruptcy Institute reported that the number of Americans seeking refuge from debt in bankruptcy court nearly doubled from 1990 to 1997. Approximately 500,000 Americans filed chapter 7 bankruptcies in 1990 compared to almost one million chapter 7 filings in 1997. VISA credit card company asked 50,000 borrowers what their main reason was for filing bankruptcy. Twenty nine percent cited overextended finances, 15% cited unemployment, 15% said medical or health reasons, 10% said divorce or separation, 3% cited taxes and 28% gave miscellaneous reasons.

These data indicate there remain a small, but increasing number of people who do not meet their financial obligations, whose credit card accounts become delinquent and who file bankruptcy. Who are these people? If we knew them better, would creditors and collectors improve collection rates? A situational and behavioral classification of delinquent debtors could provide valuable information allowing collectors to predict the payment probability of individuals and to modify collection techniques accordingly. To the author's knowledge, this classification scheme does not yet exist. There have been a few attempts to describe the psychology of indebtedness and the personalities of debtors. These nonempirical and speculative typologies can, at best, be helpful in the initial formulation of questions to be used in questionnaire surveys of delinquent debtors.

The Psychology of Indebtedness

In an article appearing on the Internet, John Driggs, LCSW wrote of the silent suffering of indebtedness. He defined responsible indebtedness as the gradual repayment of a loan backed by collateral. Problematic indebtedness refers to purchasing items one cannot afford through use of increasing amounts of unsecured loans. Compulsive indebtedness is an addiction to irresponsible overspending and consumption. Those afflicted with compulsive indebtedness exhibit unrealistic rescue fantasies, a false sense of entitlement and optimism, a sense of euphoria about receiving a new credit card and using it on a buying binge and denial of inevitable, negative consequences. Driggs speculates that such people fill an emotional void in themselves by financial scheming and overspending.

"Affluenza" is a term popularized by the Public Broadcasting Service and refers to "a dysfunctional relationship with money, wealth and its pursuit". Proponents of the affluenza epidemic proclaim that those afflicted show an inability to delay gratification, a low frustration tolerance, loss of future motivation, low self-esteem, entitlement and preoccupation with external appearances. PBS claims that affluenza represents "an epidemic of stress, overwork, shopping and indebtedness caused by the dogged pursuit of the American dream".

Anselm Bassano, writing for Legal and Trade Collections, Ltd., concluded, "Listening to each debtor and attempting to understand the state of mind can be an effective tool in securing payment". In his rendering of the psychology of debt, Bassano classified debtors into four types. "Panickers" borrow more to meet existing debts, pay creditors on a rotational basis and are unlikely to correctly prioritize their repayments. "Mourners" deny their debt initially and then become angry and blaming of others, usually the creditor or collector. "Rationalists" rank order their debts according to importance and negotiate payment plans according to available

resources. And "fraudsters" set out to abuse the system and have no intention of paying.

Another approach to classifying debtors is in terms of (neurotic) spending styles. In her book, *The Overspent American*, Juliet Schor defines competitive spending as an aggressive, reference-group "keeping up with the Jones" aimed at establishing and maintaining status. Additionally, authors David Krueger, in his book *Emotional Business*, and Ellen Mohr Catalano and Nina Sonenberg, in their book *Consuming Passions*, and I have added compulsive spending (to alleviate inner emptiness), co-dependent spending (to create dependency in others), narcissistic spending (to look good and overcome inner inferiority) and revenge spending (spending a loved one's money to exact punishment). These categories of spending style are included in the customer questionnaire described below.

A significant problem with these efforts to classify debtors is that they pathologize indebtedness. The unspoken bias is toward concluding that these are either bad or mentally ill people. To accept this bias as true puts the debt collector into the awkward role of either prosecutor or psychiatrist. Debt collectors are neither prepared nor do they presume to play these roles. On the contrary, the assumption that bad things happen to good people allows collectors to assist debtors in resolving delinquencies without the complications of multiple and ambiguous roles.

Customer Profiles

An empirical, rather than a clinical approach to classifying delinquent debtors avoids the pitfalls of the above-mentioned efforts. In a personal communication with the author, Kevin Keleghan, Chief Credit Officer for Sears Credit, reported the results of 200 structured interviews with Sears' customers whose accounts had become delinquent. He derived six conceptual clusters of delinquent customers that include: 1) the imprudent (who have no money put away for a rainy day and live financially one day at a time); 2) the naïve (who are ignorant of the consequences of too much debt); 3) fortune's victim (for whom, despite adequate planning, some catastrophic life event caused financial collapse); 4) the reckless spender (who spends beyond his or her means); 5) the unethical (who have no intention to repay); and 6) the impoverished (the high-risk customer to whom a card was issued to by accident). Keleghan suggested methods of collection for each of these clusters, including credit counseling, closing the account and taking legal action. This is an initial, empirical attempt to use data on the history of indebtedness to guide the collection of debt.

A large-scale survey of debtors whose credit card accounts became delinquent and were charged-off, but were subsequently paid in full, will allow information to be gathered on 1) the reasons their accounts became delinquent and 2) their reasons for payment. From these data, a statistical algorithm can be derived that will permit the prediction of the probability of payment from the history of the debt. An evaluation of the accuracy of these predictions can be based on actual payments received to determine the predictive validity of the algorithm. A questionnaire that samples these two domains, history of delinquency and reasons for payment, was under development at CFS before the company ceased operations. It was constructed conceptually from anecdotal data included in letters from CFS customers and included the following reasons for indebtedness: changes in life circumstances that effect net disposable income (e.g., job/income loss, family developments, illness) and personality factors (e.g., ability to delay gratification, spending styles). Initially, it was mailed to 750 CFS customers who had paid in full. This questionnaire appears below along with some preliminary results. (04/04)



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