HOW MUCH DO CREDIT CARD COMPANIES KNOW ABOUT YOU?

When Kevin Johnson returned from his honeymoon, a letter from American Express was waiting for him. The letter informed Johnson that AmEx was slashing his credit limit by 60 percent. Why? Not because Johnson missed a payment or had bad credit. The letter stated: "Other customers who have used their card at establishments where you recently shopped, have a poor repayment history with American Express." Johnson had started shopping at Walmart. Welcome to the new era of credit card profiling.

Every time you make a purchase with a credit card, a record of that sale is logged into a massive data repository maintained by the card issuer. Each purchase is assigned a four-digit category code that describes the type of purchase that was made. There are separate codes for grocery stores, fast food restaurants, doctors, bars, bail and bond payments, and dating and escort services. Taken together, these codes allow credit card companies to learn a great deal about each of its customers at a glance.

Credit card companies use these data for multiple purposes. First, they use them to target future promotions for additional products more accurately. Users that purchase airline tickets might receive promotions for frequent flyer miles, for example. The data help card issuers guard against credit card fraud by identifying purchases that appear unusual compared to a cardholder's normal purchase history. The card companies also flag users who frequently charge more than their credit limit or demonstrate erratic spending habits. Lastly, these records are used by law enforcement agencies to track down criminals.

Credit card holders with debt, the ones who never fully payoff their balances entirely and thus have to pay monthly interest charges and other fees, have been a major source of profit for credit card issuers. However, the recent financial crisis and credit crunch have turned them into a mounting liability, because so many people are defaulting on their payments and even filing for bankruptcy. So the credit card companies are now focusing on mining credit card data to predict cardholders posing the highest risk.

Using mathematical formulas and insights from behavioral science, these companies are developing more fine-grained profiles to help them get inside the heads of their customers. The data provide new insights about the relationship of certain types of purchases to a customer's ability or inability to payoff credit card balances and other debt. The card-issuing companies now use this information to deny credit card applications or shrink the amount of credit available to high-risk customers.

These companies are generalizing based on certain types of purchases that may unfairly characterize responsible cardholders as risky. Purchases of secondhand clothing, bail bond services, massages, or gambling might cause card issuers to identify you as a risk, even if you maintain your balance responsibly from month to month. Other behaviors that raise suspicion: using your credit card to get your tires re-treaded, to pay for drinks at a bar, to pay for marriage counseling, or to obtain a cash advance. Charged speeding tickets raise suspicion because they may indicate an irrational or impulsive personality. In light of the sub-prime mortgage crisis, credit card companies have even begun to consider individuals from Florida, Nevada, California, and other states hardest hit by foreclosures to be risks simply by virtue of their state of residence.

The same fine-grained profiling also identifies the most reliable credit-worthy cardholders. For example, the credit card companies found that people who buy high-quality bird seed and snow rakes to sweep snow off of their roofs are very likely to pay their debts and never miss payments. Credit card companies are even using their detailed knowledge of cardholder behavior to establish personal connections with the clients that owe them money and convince them to payoff their balances.

One 49-year old woman from Missouri in the throes of a divorce owed $40,000 to various credit card companies at one point, including $28,000 to Bank of America. A Bank of America customer service representative studied the woman's profile and spoke to her numerous times, even pointing out one instance where she was erroneously charged twice. The representative forged a bond with the cardholder, and as a result she paid back the entire $28,000 she owed, (even though she failed to repay much of the remainder that she owed to other credit card companies.)

This example illustrates something the credit card companies now know: when cardholders feel more comfortable with companies, as a result of a good
relationship with a customer service rep or for any other reason, they're more likely to pay their debts.

It's common practice for credit card companies to use this information to get a better idea of consumer trends, but should they be able to use it to preemptively deny credit or adjust terms of agreements? Law enforcement is not permitted to profile individuals, but it appears that credit card companies are doing just that.

In June 2008, the FTC filed a lawsuit against CompuCredit, a sub-prime credit card marketer. CompuCredit had been using a sophisticated behavioral scoring model to identify customers who they considered to have risky purchasing behaviors and lower these customers' credit limits. CompuCredit settled the suit by crediting $114 million to the accounts of these supposedly risky customers and paid a $2.5 million penalty.

Congress is investigating the extent to which credit card companies use profiling to determine interest rates and policies for their cardholders. The new credit card reform law signed by President Barack Obama in May 2009 requires federal regulators to investigate this. Regulators must also determine whether minority cardholders were adversely profiled by these criteria. The new legislation also bars card companies from raising interest rates at any time and for any reason on their customers.

Going forward, you're likely to receive far fewer credit card solicitations in the mail and fewer offers of interest-free cards with rates that skyrocket after an initial grace period. You'll also see fewer policies intended to trick or deceive customers, like cashback rewards for unpaid balances, which actually encourage cardholders not to pay what they owe. But the credit card companies say that to compensate for these changes, they'll need to raise rates across the board, even for good customers.


**CASE STUDY QUESTIONS**

1. What competitive strategy are the credit card companies pursuing? How do information systems support that strategy?

2. What are the business benefits of analyzing customer purchase data and constructing behavioral profiles?

3. Are these practices by credit card companies ethical? Are they an invasion of privacy? Why or why not?

**MIS IN ACTION**

1. If you have a credit card, make a detailed list of all of your purchases for the past six months. Then write a paragraph describing what credit card companies learned about your interests and behavior from these purchases.

2. How would this information benefit the credit card companies? What other companies would be interested?