Bubb and Kaufman (Working Paper 2009)
Consumer Biases and Firm Ownership

Summary:

- Ownership of the firm by its customers can be used as a commitment device to avoid offering contracts that exploit consumer biases.
- Assume investor-owned firms are unable to commit to a "consumer-friendly policy" and managers in mutual companies don't have incentives to exploit.

Hypothesis:

- Mutually owned and nonprofit firms are less likely to use contracts that take advantage of consumer biases than investor-owned firms.
- The differences between the contracts induce sorting of naïve customers into investor-owned firms and sophisticated customers into mutual firms.

Methodology:

- OLS regression of contract terms on whether the firm is a credit union controlling for lending volume (firm size) and card type indicators (proxy for creditworthiness).
- Matching estimator (match on card type and firm lending volume) on contracts for which there is covariate overlap to allow for flexibility in functional form.
- Probit of whether a consumer uses a credit union on their perceived and actual costs of avoiding penalties.
    - Proxy for consumers' perceived cost of avoiding penalties using whether customers chose "low fees or service charges" as the most important reason for choosing their banking institution.
    - Proxy for consumers' actual cost of avoiding penalties using whether credit card holders carry a non-zero balance.

Results:

- Credit unions offer higher base prices and lower penalty prices.
    - Credit unions much less likely to offer special intro APR, and the rates are higher than investor-owned issuers.
    - Credit unions offer lower default APR rates and lower fees.
- Consumers' perceptions of their vulnerability to penalties are correlated with the use of credit unions, but those who are actually most vulnerable are not more likely to use credit unions.
    - People more concerned about fees are more likely to use a credit union.
    - Carrying a credit balance has no statistically significant effect on holding a credit union credit card, evidence of naiveté.

Issues:

- Endogeneity: reverse causality-what credit contracts are offered could be due to consumer demand.
- Measurement error: proxy for consumer perception and actual vulnerability are inaccurate indicator variables.
- Alternative hypotheses:
    - Market definition: the respective markets each type of firm competes in are different.
    - Customer selection: credit unions target different customers.

    - Tax treatment: credit unions are exempt from the corporate income tax.
    - Interest rate caps: credit unions are subject to an interest rate cap.
- Alternative strategy: it has been shown that credit unions and investor-owned firms offer different credit card contracts, but the evidence on consumer sorting is preliminary.
    - Field experiment offering consumers the different contracts from each type of firm.
    - Use menu choice to elicit perception of cost of avoiding penalty.
    - Use experimental variation to measure actual cost of avoiding penalty.