

FOR WANT OF LAW AND ORDER

The thriving credit card industry lacks the strong arm of the law to deter defrauders and defaulters.

CREDIT CARD operators have been called licensed Shylocks, among other names. The purveyors of plastic now stand accused of other sins. Example: a debate is currently raging over whether cards actually fuel inflation.

Tan Sri Ramon Navaratnam, chief executive of Bank Buruh said in a recent press report that the relative ease with which banks had been issuing credit cards to its account holders was clearly a factor in raising consumption spending. He also said that the expenditure on luxury goods, which often exerts greater inflationary pressures, could be curbed through limited use of credit cards. Navaratnam argued that a key consideration for controlling consumer spending would be the tightening of credit extended to consumers.

Consumers, however, are not about to stop applying for them. Statistics from the Ministry of Finance indicate that there were, as at June 1991, 834,811 credit card-holders and 191,678 charge card-holders. The figures, say bankers, keep mounting.

Both the demand and supply of credit cards are overwhelming. Banks and financial institutions issuing them in Malaysia are more aggressive than ever in their promotion campaigns to offer the plastics to 'deserving' consumers. Among the reasons: the industry in Malaysia has an annual growth rate of 40 per cent, and there are still about 1.2 million potential card users still untapped.

Whether or not credit cards are a factor in fuelling inflation is, at the moment, a moot point. Granted, the relatively easy credit afforded by cards has driven the average consumer to spend now and pay later: in effect, borrowing on tomorrow. An industry observer says that such behaviour stems from the consumer's confidence of his ability to pay because of the economic boom.

Analysts contacted by **Malaysian Business** concur that the economy will slow down gradually. According to the Malaysian Institute of Economic Research (Mier), the growth rate for 1992 has been forecasted at 6.5 per cent, compared with a forecast 7.9 per cent this year.

Even so, corporate earnings have been solid and wages have been rising. This in turn has fuelled consumer spending and applied pressure on prices. Currently inflation is running at an annual rate of approximately 5 per cent.

Consumer lending – hire purchase schemes, housing loans, overdrafts or share financing and personal loans – all contribute to inflation in their own way. So says K K Ng, president and managing director of MBf Card Services, the largest credit card issuer in Malaysia, with some 30 per cent share of the estimated 650,000 credit/charge cards of all brands in 1990. For 1991, MBf Card Services expects to capture 70 per cent of the MasterCard market and 40 per cent of the total market.

Ng argues that the actual volume of consumer lending on a credit card would be much lower than that of an automobile hire purchase agreement or a housing loan. 'The issue here is whether consumer lending is inflationary, not whether the use of credit card is inflationary.'

In addition, as lending related to credit cards is just another form of consumer credit, whether or not it is a contributing factor to inflation should be examined alongside other vehicle of consumer lending and not in isolation, Ng explains. "As it is, the credit card cannot be charged as the sole culprit of inflation.'

'Consumer spending is going up. There's no question about it,' says Maria Suen Palm, retail business consultant at Standard Chartered Bank. 'It is a growing economy.' Palm says the economy is bound to have a disproportionate effect on consumer spending. Economist Dr R Thillainathan, director of finance at Genting Berhad says, 'The big surge in spending has been caused by the pent up demand associated with a near collapse in demand for consumer durables in the mid-1980s and the phenomenal economic growth of the late 1980s.'

The current surge in consumer spending as Thillainathan succinctly puts it, is 'only something to be expected.' Unemployment stands at approximately 5 per cent, a figure most economists reckon as full employment. 'People are getting jobs and looking for a higher quality of life. They are also travelling more,' Palm says.

According to Palm, consumption credit has been growing at more than 70 per cent a year over the past two years, outstripping even the growth in credit extended to the manufacturing sector. The total consumption credit in 1989 from banks and finance companies was 6.6 billion rgt. Just last year, the figure shot up to 11.6 billion rgt. Palm says finance companies accounted for 4.3 billion rgt of the total increase while the remaining 700 million rgt was attributed to banks. The value of credit cards outstanding is about 1 billion rgt, says Palm, accounting for 8.6 per cent of the total credit consumption in 1990.

A big chunk of consumer credit, Palm and Ng agrees, comes from the financing of houses and condominiums and also from the hire purchase of automobiles. 'As a result of Bank Negara's recent intervention, purchasing vehicles and other luxury items is now slightly more difficult,' Palm says. 'But looking at overall consumer credit,' she adds, 'most of it has got to do with non-credit card transactions. Besides how would 3 to 4 per cent of the population holding a card have such an impact on inflation or the economy?'

'We never force the card-holder to use the credit line. The credit facility is there and you have the option to use it. If the card-holder wants to use it and is willing to pay the interest charged no one can stop him,' Pam adds.

Martin Cook, Hongkong & Shanghai Banking Corporation (Hongkong Bank) manager of card products division agrees. 'The credit facility on the credit card is secondary to what credit card is all about,' he says. 'A credit card is there to help you avoid the necessity of cash on a day-to-day basis and for major transactions.' The primary use of credit cards, according to Cook, is for normal day-to-day travel and entertainment purposes and retail spending.

He adds that the credit card cuts down on paper work. Long regarded as an easy and convenient way to obtain credit during emergencies or in the short term, the average consumer continues to

flock to credit card operators. Palm says that owning a credit card is better than going through the hassle of taking a loan from banks or finance companies, especially for items like a hi-fi system or a refrigerator.

‘We don’t like to see people take a credit card and then draw down the cash in one lump sum. We would be quite concerned as to what the cash will be used for,’ says Cook. ‘If they wanted a loan, they should actually go to the bank or finance company. That’s cheaper money when you take the interest charged into account.’ He says that if card-holders use money drawn out from their credit cards to gamble or buy shares, they are actually abusing the credit facility proffered to them.

Francis C Y Yee, Chung Khiaw Bank (CKB) head of consumer banking division says that when the economy is good, ‘the consumers are a little easy on their pockets.’ Whether or not the average consumer will run into trouble by overspending depends heavily on his or her discipline, Lee reckons.’ The credit card is a convenience card and even without it, people will still spend,’ he adds.

A major gripe in the industry presently is the contention that consumers with an annual income of less than 18,000 rgt should not be granted any form of credit facility. The reason: they are a high risk group.

Ng and Lee disagree. Says Ng, ‘Income level is relative. The thought that the credit card is meant for people who earn 2,000 rgt and above should not be there anymore. I think it’s wrong to say that. We don’t have statistics indicting that a person with an income of 700 rgt is less responsible in his repayments than a person with a 70,000 rgt income. Each of these people have their respective incomes to manage their own lifestyles.’

‘A lot of young graduates and professionals are coming into the market,’ says CKB’s Lee. ‘By virtue of having a tertiary education, we will assume them to be responsible and credit smart. They will be the business leaders of tomorrow. We’ll take a chance on them and let them grow with us.’ The latest entrant to the credit card scene, CKB’s main target segment is the 18,000 rgt income group. To begin the uphill task of carving a share for itself, CKB waives the joining fee and the first year annual fee for its successful applicants.

Palm says the middle income group is a highly attractive group for credit card operators because of their income potential and earning ability. ‘We don’t expect their income levels to stay stationary,’ Palm says. ‘As and when their income level increases, their potential to buy and pay will also increase correspondingly. ‘The risks are everywhere,’ says Lee. ‘The important thing is managing these risks efficiently.’

‘We must recognise the increasing maturity of the consuming public, Ng explains. ‘The credit card should generally be seen as a payment instrument replacing cash. People have daily payment needs regardless of their income levels. It’s a way to educate people in money management. More importantly, people are generally more understanding and accepting of the credit card and what it entails.’

And let’s face it. As profit-oriented organisations, credit card operators often make prudent business decisions. While it is true that profits will only roll in when they achieve a certain economy of scale, the high interests levied on the credit issued, approximately 18 to 24 per cent,

also serve to spread risks on unsecured lending and cover the costs incurred in the capital-intensive business. 'The interest rates are high mainly because of the high risk involved,' says Lee.

Stringent credit assessments to evaluate the credit-worthiness of a potential card-holder are carried out. And there is more to just looking at the applicants' annual income. Among other factors, Hongkong Bank's Cool says that their other financial commitments are also considered. How many other credit cards the applicants have and job stability are some important elements. 'In this industry a wrong decision will wipe out 100 other good decisions and that's not a very fair margin to play. If you give one bad card out, it's 100 good cards that you've wipe out on profits.

And even when all bases are covered, bad debts still occur. 'We are quite comfortable with delinquent accounts,' says Lee. 'But not with people who apply for a card legally with the intention to defraud and know the loopholes in the system to do so.' All credit card operators contacted by **Malaysian Business** agree that fraud is a major concern for the industry.

They collectively appeal to Bank Negara to work closely with the industry to prevent fraud. 'At this time the credit card industry is at the mercy of people who defraud us,' says one operator who seeks anonymity. 'Many of the cases involving delinquent accounts have real and proven intentions of defrauding. But it's a civil case and not a criminal case. It's the law. You cannot charge somebody for overspending or for going above their card limits.'

Despite the ubiquitous use and growth of credit card facilities, there are currently no specific regulations and statutes governing the credit card industry. Bank Negara is concerned and currently has the credit card industry under review. Deputy minister of finance, Abdul Ghani Othman said recently that the changes will take into account the provisions of the Banking and Financial Institutions Act (Bafia).

Some industry changes are expected at year end involving regulations on accessibility, extension on credit lines and tighter procedures on fraud control and doubtful accounts. There are also indications that Bank Negara may put a stop to credit cards being issued to people earning about 700 rgt/month and below 18 years of age. Says Abdul Ghani in a recent press report, 'Such generous provisions are obviously tempting people to live on credit.'

'It's very expensive to run a card operation,' says Palm. 'If Bank Negara stipulates that only those with 24,000 rgt and above can get a credit card, many card companies will lose a major portion of their market share overnight.' And if the central bank increases minimum repayment form the current 5 per cent of the balance to 10 per cent, those in the lower income group will be hard hit, Palm adds.

The government's effort to control inflation with its fiscal and monetary policies will not be effective if consumer spending continues unabated. Increasing interest rates to reduce market liquidity, for one, has already seen some effects. But consumer spending continues to soar. And several physical controls and interventions have been recommended.

'I would argue against such selective controls,' says Thillainathan. 'They are inefficient and invariably ineffective.' According to Thillainathan, these selective controls will interfere with the smooth operation of market forces. The controls will be ineffective because the control of

consumption in one direction will cause a spillover effect on expenditure in another direction. For instance, instead of spending on a car, the consumer now spends on an overseas vacation, he explains. 'There is generally the problem that interfering with market forces causes circumvention of one form or another and it may not necessarily attain the desired objective.'

Thillainathan also says that inflationary pressures has nothing to do with the use of credit cards. Inflation, as Thillainathan puts it, depends on the overall level of economic activities and money supply. He says any control of credit or charge cards will lead to the substitution of one mode of payment for another or one type of debt for another. Efficiency will then suffer as the credit or charge card is an efficient way to settle payments and to borrow especially if the line of credit is small and unsecured.

'If it's felt that aggregate spending is growing at a faster rate than aggregate supply,' Thillainathan says, 'the best way to deal with the problem is not through selective controls.' He recommends tightening monetary policy and weakening the exchange rate. 'Those measures have the added advantage of minimising the distortion in resource allocation.'

Mier executive director, Datuk Dr Kamal Salih, said recently: 'It's not the stage for strong measures. Inflation is still manageable and one should not over-react. If there's too much monetary tightening, it may lead to distortions and in the process stunt economic growth.'

The credit card industry awaits the recommendations of Bank Negara. While regulations may streamline credit management, the fact remains. An increasingly sophisticated market will continue to clamour for more efficient modes of payment, and credit cards will play a leading role. Trusting the consumer to regulate himself is difficult. The solution: regulate the industry. The argument is simple. The consumer cannot live on credit. But if he has the means to repay his credit, why not?