

DO CONSUMERS UNDERSTAND PCP CAR FINANCE? AN EXPERIMENTAL INVESTIGATION

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INTRODUCTION

This study tested consumers' understanding of an increasingly common type of car finance. Personal Contract Purchase (PCP) plans have risen to prominence in the Irish market in recent years. These deals typically involve lower monthly payments than Hire Purchase (HP) deals or personal loans, allowing consumers to benefit from increased affordability. However, PCP plans are relatively complex and involve potential drawbacks that may not be properly understood by consumers. For instance, they involve some risk, because a consumer's financial position at the end of the deal depends on prices in the second hand car market.

In collaboration with the Competition and Consumer Protection Commission (CCPC), the ESRI Behavioural Research Unit designed an experiment to address two main research questions: (i) How well do consumers understand PCP plans? (ii) Can understanding be improved via disclosure or advice?

METHOD

A representative sample of 100 consumers undertook multiple tasks in a controlled laboratory experiment. At the outset, the participants were given the clearest information on PCP deals that the research team could find, based on what consumers currently see in the marketplace. They then completed three tasks that probed different aspects of understanding: choosing between pairs of car finance packages; rating PCP offers on a 1-7 scale; and answering multiple choice questions about how PCP finance works. Half of the participants then read independent advice about PCP deals taken from CCPC's website, while the other half received advice that included an explanatory diagram. Understanding was then measured again. Participants were rewarded for accurate responses.

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RESULTS

Consumers made significantly more inconsistent decisions when choosing between pairs of PCP deals than when choosing between pairs of more traditional Hire Purchase deals. When rating PCP offers, almost one quarter of the time, consumers judged an inferior deal to be better than another that was objectively superior. Perhaps most striking was performance on the multiple-choice questions. Comprehension of the central facts and concepts surrounding PCP deals was poor, with 23 of the 100 participants performing no better than chance. This was despite rewards for good responses and the fact that more than half of the sample were educated to degree level.

Encouragingly, however, errors reduced significantly after participants read the independent advice. Ratings became more accurate and answers to comprehension questions improved, especially among the group that received the advice that contained an explanatory diagram.

POLICY IMPLICATIONS

The findings raise concerns from a consumer protection perspective and suggest that PCP plans should be considered a complex financial product. The scale of misunderstanding recorded implies that many car buyers are unlikely to grasp important aspects of these large financial transactions. Of particular concern is comprehension of what can happen at the end of a PCP deal. A proportion of consumers may be surprised to discover that after putting down a deposit, making three years of monthly payments, caring for the car and staying within agreed mileage limits, they end up owning little or no asset in return.

The experiment also suggests that consumers considering PCP deals need good, independent advice. Its findings can be used to improve the effectiveness of material generated by policymakers. They also raise the issue of how best to get good advice in front of car buyers. Overall, the scale of misunderstanding revealed here can be taken to support a more interventionist approach, perhaps mandating more effective disclosures at the point of sale or standardising some aspects of PCP deals. Such interventions could be experimentally pre-tested for effectiveness.

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