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Consumer Preferences for Payment Methods: Role of Discounts and Surcharges

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Abstract:
We use new data from the 2015 Diary of Consumer Payment Choice to analyze the role of consumer preferences for specific payment instruments, and how price discounts and surcharges based on payment method affect payment instrument choice. We test whether consumer demand for payment instruments is price elastic, namely whether consumers are likely to deviate from their preferred methods in order to get a discount or to avoid a surcharge. We find that the occurrence of price incentives is low, but that given cash discounts, the probability that a cash transaction is conducted by a consumer who prefers other payment methods increased by 19.2 percent, after controlling for merchant category and dollar value of the transaction. Payment method choice is affected very strongly by consumer individual preferences, but steering by merchants may be effective under some circumstances. Both merchants' reluctance to offer price discounts and consumers' limited response to them lead to the low observed occurrences of such incentives.

Keywords: Consumer payments, consumer preferences, merchant steering, discounts, surcharges

JEL classifications: D03, D14, G02

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This paper, which may be revised, is available on the web site of the Federal Reserve Bank of Boston at http://www.bostonfed.org/economic/wp/index.htm.