Student loans at local credit unions: exploring consumer profiles and product features

Sung David Chun
Mercy College of Ohio

Yeojun Caleb Chun
HCR ManorCare

Sock Chung
Eastern Michigan University

ABSTRACT

This paper discusses the first examination of the target consumer and preferred features of student loans offered by U.S. credit unions. The Health Care and Education Reconciliation Act of 2010 (HCERA) ended the process of private banks issuing loans subsidized and insured by the federal government. Instead, federal loans will be administered directly by the Department of Education. Thus, private lenders are now limited to private student loan programs. In particular, U.S. credit-unions should decide whether or not to market their own private student loan products. Analysis of a convenience survey of 66 university customers shows that the best target group is females at private schools. The most important feature of a student loan is the interest rate. It is also important to design a product that offers flexibility but is still easy to understand.

Keywords: credit union, student-loan, financial service, bank, financial product

INTRODUCTION: OVERVIEW OF STUDENT LOAN MARKET

In order to fund their college education, typical students first take scholarships and grants and then borrow the maximum amount for which they qualify in Federal loans (Stafford and Perkins), as these are the cheapest options available. The difference between the cost of attendance and total aid received is referred to as the "gap". This gap can be filled in a number of ways; the most common methods include using personal funds, family funds, PLUS Loans (another Federal program), and private student loans. Each option carries its own benefits and disadvantages, and often the choice comes to personal preference and ability.

In the past, many private lenders (banks, credit unions, and other specialized lenders such as Sallie Mae) offered both Federal (Stafford and PLUS) loans and private student loans. Lenders enjoyed the benefits of these Federal programs, as the funds were guaranteed by the government, meaning that if a borrower failed to pay, the lender's money was returned by the government. The lower risk of these loans made them very appealing. The higher returns offered by private loans often made these programs another good option for lenders. In 2010, however, the Health Care and Education Reconciliation Act (HCERA) was passed, which prevented private lenders from making new Federal student loans. Students are still able to borrow these loans directly from the government, but private lenders are now limited to private student loan programs.

Although the full ramifications of this legislation have yet to be realized, many lenders responded immediately by discontinuing all educational lending (Waters, 2010). Nationally, nearly half of all lenders that still offer student loans to their customers do so through Sallie Mae's loan program (Kantrowitz, 2011). Despite this exodus, the student loan market is actually expanding due to the rising cost of attending college. Private student loans are increasing at the greater rate than federal loans. In recent years, private loans have grown at 25% annually, compared to growth of 8% for Federal loans (Kantrowitz, 2011). College costs are rising steadily; from 1980 to 2008, inflation-adjusted costs rose over 359% for public schools and 286% for private schools. From 2007 to 2008 alone, costs rose 6% (Baum & Ma, 2010). Although costs are rising, Federal loan limits have not increased since 2007, and historically have only increased every 15 years. Unemployment rates continue to be high (8.8% nationally) (U.S. Department of Labor, 2011), which means that parents are less likely to have money available to pay for their children's' education.

CREDIT UNIONS' INVOLVEMENT IN THE STUDENT LOAN MARKET

Credit unions are private financial co-operatives, owned and operated by their members who are often associated with a university or a large group with a common denominator. The credit unions' traditional products are small, short-term loans. As a result, members have begun to demand more innovative financial services. However, credit unions face tight regulations. The National Credit Union Administration (NCUA) regulates credit unions much like the FDIC regulates banks. NCUA rules limit both the group of people who can qualify for membership and the length of a loan term. Additionally, the Obama administration is enforcing more openness in private student loans through regulations and disclosure requirements (Vasques, 2011). New rules require lenders to disclose rates, fees, and other costs. These disclosures must also include a statement that Federal loans are a "lower cost" option (Board of Governors of the Federal Reserve System, 2010). The administration is also strongly encouraging Federal loans over private lenders, with HCERA eliminating private lenders' ability to offer Federal loans and driving many lenders out of the

student loan market altogether. This heavily regulated environment could make student loans even more expensive to offer and maintain in the future.

Despite these remarkable regulations imposed on credit unions, it should be noted that the market for private student loans is still growing (Waters, 2010). First of all, the rate of college attendance is increasing. More than 70% of the high school class of 2009 enrolled in college. This is the highest percentage on record, dating back to 1959 (Rampell, 2010). The number of jobs requiring a college degree is also increasing and is expected to continue increasing in the future; from 1973 to 2007, it increased from 28% to 58%, and is expected to further increase to 63% by 2018 (Carnevale et al., 2010). In 2009, 38.5% of undergraduate students took out some type of loan, with an average of $7,100 borrowed per student (U.S. Department of Education, 2009). For graduate students, 42.7% had taken some type of loan, with an average of $18,500 borrowed per student (Wei et al., 2009). Additionally, by gaining members when they are students, credit unions can guarantee a connection to members for at least the duration of loan repayment, as much as 15 years. This long interaction can provide credit unions with additional opportunities to cross-sell more products and services to these borrowers.

RELATED LITERATURE

While there is a considerable literature on banking markets, it has focused almost exclusively on commercial banks and to a lesser extent on savings and loans. In particular, how the Health Care and Education Reconciliation Act of 2010 (HCERA) has affected credit unions in the student loan market is not known. Heaton and Dunham (1985) discussed why credit unions in New England have quite large shares of the consumer deposit. Kaushik and Lopez (1996) found that credit unions on average are as profitable as both commercial banks and savings banks, and that their loan portfolios have grown more rapidly. Tokle and Tokle (2000) found that credit unions impacted bank CD rates offered in Idaho and Montana. The implication of these findings is that credit unions may be a substantial threat to commercial banks. More recently, Feinberg (2001) examined credit unions' impact in a broader sample of relatively small local markets and identified a competitive effect of credit unions on bank loan rates. His research (Feinberg, 2002) also examined the type of competition existing between credit union and commercial banks. His results are more consistent with the view of credit unions as "fringe suppliers" rather than competitors. Credit unions are price-takers in a homogenous product market. To the best available knowledge, there is only one investigation which deals specifically with financial products offered by credit unions: Tripp and Smith (1993) examined credit unions that initiated first-mortgage lending programs and found that the size of the credit union, a full-service orientation, and a residential type of membership bond were consistently significant in their relationship to first-mortgage initiation. However, no research has been found in the field of marketing and management that deals with student loan products offered by credit unions. This paper aims to discuss the first effort to examine the target consumer and preferred features of student loans offered by U.S. credit unions.

RESEARCH QUESTIONS

How can a local credit union expand its university student loan product? Credit union management would like to look into expanding the private loan program by creating a new loan product that could eventually be expanded nationwide. To do this, management needs to identify the best potential target market and how to position its student loan product in its local market. Management would like to design the best product by exploring which loan features are most important to borrowers and what level of complexity attracts consumers. They would also specifically like to know if they can leverage the advantage of being a local lender.

METHOD

Sample and Data Collection

After extensive background research, including Simmons data on the student loan market, a self-administered questionnaire was executed. A total of 66 surveys were obtained at 4 campuses in a northern Indiana town. Table 1 (Appendix) compares the demographic characteristics of the survey sample and the total population by school type. The collected sample is not similar to the population in terms of the gender composition but average age is comparable. The survey included questions on attitudes toward borrowing, desired loan features, lenders, decision makers, sources of information, sources of funding, and a sample loan offer from a local credit union, including likelihood of responding to the local credit union's offer and reasons for liking or disliking it. This paper summarizes main findings from this sample survey.

Measures

The major dependent variables are either a scale of 1 to 5 or of 0 to 100, with the lower value indicating a negative response and a higher value representing a higher response, depending on the question. The following features for an example student loan product were suggested.

- Rates range from 5.25% to 9.25% depending on credit history and repayment option. Students can get a lower rate by applying with a cosigner with good credit and by choosing to make payments while in school.
- The term is 15 years, starting from the first disbursement.
- Repayment term can be extended with a consolidation loan at graduation.
- Once the student graduates, the loan enters a 6-month grace period before payments begin.
- The annual limit is $15,000 for undergraduate students, with a maximum of $75,000 total. There is no limit for graduate students.

Table 2 (Appendix) compares this product to other loan products offered by commercial banks. The major competitors are all national lenders: Sallie Mae, Citibank, Chase, and Wells Fargo.

HYPOTHESES DEVELOPMENT

Gender of Target Market

Earlier Simmons research uncovered a striking difference in the student loan market between males and females; namely, females are much more likely than males to have borrowed a student loan from a credit union (indices of 136 vs. 61). This may be partially explained by college enrollment numbers: as of 2008, 57% of college students were female (Snyder & Dillow, 2010). However, this alone does not completely explain why more females borrow private student loans. The specifically designed, experimental loan product was tested against gender. Based on preliminary research, females were expected to be significantly more likely to have private student loans and to choose the designed loan product.

H1: Females have significantly more past usage of private student loans than males.
H2: Females have significantly higher expected future usage of private student loans than males.
H3: Females are significantly more likely to respond to an experimental loan offer than males.

School Type of Target Market

As management expects to first open the product only in the local market, the results from local schools relative to the credit union were examined, comparing the more expensive private university students to the less expensive public university students. It was hypothesized that more private university students would use private loans, since cost of attendance is higher and students will have a larger gap to cover. It was also expected that private school students would be more likely to respond to the experimental product offering; due to the larger gap, they are more likely to be informed about borrowing options and determine that the loan has a high value.

H4: Private schools' students have significantly higher past usage of private student loans than public schools' students.
H5: Private schools' students have significantly higher expected future usage of private student loans than public schools' students.
H6: Private schools' students are significantly more likely to respond to the experimental offer than public schools' students.

Product Features

The first experiment ran a set of 1-sample t-tests on the various features of the student loan products (interest rate, repayment options, loan limits, and rate discounts) using a scale of 1 (least important) to 5 (very important) to determine which features are most important to students. It was expected that interest rates and loan limits would be the most important. Then using paired sample t-tests, the relative importance of these features was ranked. It was expected that interest rate would rank highest with little distinction among the other top features.

H7: Mean of importance of rate is significantly greater than mean of importance of repayment options.
H8: Mean of importance of repayment options is significantly greater than mean of importance of rate discounts.
H9: Mean of importance of rate discounts is significantly greater than mean of importance of loan limits.

Product Features' Effect on Likelihood of Response to the Current Student Loan Product

The students were asked what, if anything, they particularly liked (or disliked) about the example private loan. Then the specific experimental product was examined, first testing whether a feature's importance to a student increased their likelihood of response to the offer. The inclination was that the more straightforward parts (length of term and easiness of offer) would have a positive effect on likelihood of response while the more complicated aspects of the product offering (extended repayment option) would have a negative effect.

H10: Students' like of length of term has significantly positive effect on likelihood of response to the current credit union loan product.

H11: Students' like of easiness of offer has significantly positive effect on likelihood of response to the current credit union loan product.

H12: Students' dislike of repayment options has significantly negative effect on likelihood of response to the current credit union loan product.

ANALYSIS AND RESULTS

Gender of Target Market

Three independent sample t-tests were run on gender against each of the means of past usage of private student loans, expected future usage of private student loans, and likelihood of response to the experimental loan offer (Table 3 in Appendix).

Hypothesis 1: 21 males and 43 females responded (64 total) with means of .00 and .23, respectively (coded values were 0 for "no" and 1 for "yes"). Levene's test for equality of variances was significant (p=.000, which is <.05), so equal variances were not assumed. Thus the means are significantly different (p=.001, which is <.05), concluding that females are significantly more likely to have used private student loans in the past. H1 is accepted.

Hypothesis 2: 20 males and 30 females responded (50 total) with means of 2.00 and 2.83, respectively (scaled from 1, very unlikely to 5, very likely to use in the future). Levene's test for equality of variances was not significant (p=.179, which is >.05), so equal variances were assumed. The difference in means was significant (p=.040, which is <.05); therefore H2 is accepted, concluding that females have a significantly higher expectation of future use of private student loans than males.

Hypothesis 3: 21 males and 41 females responded (62 total) with means of 56.90 and 49.46, respectively (scale from 0-100, with 100 as extremely likely to respond). Levene's test for equality of variances was not significant (p=.892, which is >.05), so equal variances were assumed. The means were not significantly different (p=.363, which is >.05), so H3 is rejected and conclude that there is no significant difference in likelihood of response to the loan offer based on gender.

In sum, females were found to be significantly more likely to use private student loans. They are not, however, significantly more likely to respond to the survey's specific product offering.

Schools of Target Market

Again, three independent sample t-tests were run on school type against each of the means of past usage of private student loans, expected future usage of private student loans, and likelihood of response to the experimental loan offer (Table 4 in Appendix).

Hypothesis 4: 24 private university students and 21 public university students responded (45 total) with means of .29 and .05, respectively (0 is no, 1 is yes for past usage). Levene's test for equality of variances was significant (p=.000, which is <.05), and so variances were assumed to be not equal. The means are significantly different (p=.028, which is <.05), and based on the means, it is concluded that private university students are significantly more likely to have borrowed private student loans in the past; H4 is accepted.

Hypothesis 5: There were 18 respondents from both private and public schools (36 total) with means of 3.11 and 1.78, respectively (scaled from 1-5 on likelihood of future usage). Based on Levene's test (not significant at p=.246, which is >.05), equal variances were assumed. The means are significantly different (p=.003, which is <.05); H5 is accepted, concluding that private university students are more likely to use private student loans in the future than public university students.

Hypothesis 6: 24 private university students and 20 public university students (44 total) responded with means of 64.67 and 42.05, respectively (scale of likelihood from 1-100). Levene's test was significant (p=.000, which is <.05), so equal variances are not assumed. The means are significantly different (p=.016, which is <.05), so H6 is accepted: private university students are significantly more likely to respond to the experimental loan offer.

In sum, students at private schools were found to be more likely to borrow using the offered product than those at public schools. It is likely that since many private school students have used student loans in the past, they are familiar with similar products, making this offer easier for them to interpret and evaluate the value against other offers.

8.3. Product Features

A set of 1-sample t-tests of the various features of student loan products (interest rate, repayment options, loan limits, and rate discounts) against a coded value of 3 (neutral) were run to determine which features are most important to students (Table 5 in Appendix). 66 survey responses were used. Means were 4.80 for rate, 4.14 for repayment options, 4.11 for rate discounts, and 3.50 for loan limits. All t-tests were significant (respectively, p=.000, .000, .000, .001, which are all <.05), meaning that all features were significantly more important than "neutral." Then using paired samples t-tests (hypotheses 7-9), the relative importance of these features was ranked.

Hypothesis 7: 65 surveys (1 missing response for repayment options) were used, with means 4.80 (rate) and 4.14 (options). The t-test was significant (p=.000, which is <.05), concluding that the means are significantly different. H7 is accepted; rate is significantly more important than repayment options.

Hypothesis 8: 65 responses (1 missing response for repayment options) were received, with means 4.14 (options) and 4.12 (discounts). The t-test was not significant (p=.911, which is >.05), concluding that the means are not significantly different. H8 is rejected; repayment options are not significantly more important than rate discounts.

Hypothesis 9: 66 responses were used, with means 4.11 (discounts) and 3.50 (limits). The t-test was significant (p=.000, which is <.05), concluding that the means are significantly different. H9 is accepted; rate discounts are significantly more important than loan limits. In sum, interest rates, repayment options, rate discounts, and loan limits are all important features to borrowers. Interest rate is the most important, repayment options and rate discounts are tied for second, and

loan limits are the least important of these features. This will allow the focus to be on advertising what matters most to students. It will also aid credit unions in designing the product: it is most important to borrowers that they can receive a low rate, so rates should be the primary focus when designing the product as well as promoting it.

Most Important Features
1. Interest Rates
2. Repayment Options Rate Discounts
3. Loan limits

Product Features' Effect on Likelihood of Response to the Current Student Loan Product

A linear regression on likelihood of responding to the offer against the three variables was run; this resulted in 54 respondents. R^2 is .250, meaning that 25% of variance is explained by the proposed model; it is a strong model for predicting likelihood of response. The model shows that significant variables were the constant (p=.000), length of term (p=.013), easy to understand (p=.007), and disliking of extended repayment option (p=.027) (all p values significant at p<.05). The resulting regression equation is: Likelihood of response = 53.78– 18.80(Length of term) + 20.04(Easy to understand) – 43.80(Extended repayment). H11 and H12 are accepted but H10 is rejected. The regression model showed that the experimental product has a likelihood of response of 53% just based on reading the loan offer; the constant was the strongest factor in the model. The strongest variable was dislike of the repayment option, which is a complicated part of the offer. It is possible that the complexity of this option (borrowers must consolidate to gain this benefit) is what drives this negative relationship. Accordingly, ease of understanding the offer increases the likelihood of response.

Most results were expected, but the surprise was from the length of term variable: those who like the length of the term are actually less likely to respond to the offer. This may also stem from the complexity issue: the term is easy to understand, and although they like this aspect of the term, they find it too short. The final test also indicates that complexity of the offer is a strong driving factor in students' decision as to whether to respond to the loan offer. Those who found the offer easy to understand were more likely to respond, although those who found it difficult to understand were not less likely to respond. This reveals that simplicity can be an asset, but complexity is not necessarily a detriment. This is likely because student loans are generally complicated, and so complexity is expected, while simplicity is seen as a bonus.

CONCLUSION AND MANAGERIAL IMPLICATIONS

The best target market is females at private schools. Ideally, first-time borrowers, which are generally (though not always) freshmen, are preferred. The most important feature of student loans is the interest rate, so when credit unions design the new product, this is the most important feature to bear in mind. The current product has a low rate of 5.25%, which is higher than most of the competition; it would be wise to reconsider this rate in light of these findings. It is also important to design a product that offers flexibility, with multiple repayment options for example, but is still simple enough to be easily understood. Based on survey results (not reported here), it is

recommended that the idea, "everyone needs to borrow student loans", be used as part of advertisements, as this is a widely held attitude among the targeted market. It is also important to emphasize the personal customer service available at credit unions.

Unfortunately, traditional advertising is not the best way to reach this market. Financial aid is the main source of information for most students; however, regulations make it difficult to gain their recommendations. Only through building personal relationships can credit unions secure the endorsement of financial aid departments, but this is a necessary step that must be taken carefully. Word of mouth is also important; credit unions should consider incentivizing referrals, for example, in order to drive this channel. The most controllable channel is credit union websites, which should be designed to emphasize key features. Using key words can help drive internet searches to the website as well.

LIMITATIONS AND FUTURE RESEARCH

The survey was limited in its scope as only students were able to be surveyed. Considering the reported involvement of parents in the decision-making, a future area of study would include parents' preferences as well. A study could also be done to determine exactly what information students and parents search for on the internet in order to drive web searches better to credit union websites. A much more in-depth study of relevant laws and regulations is necessary before approaching financial aid personnel, but increasing the likelihood of referral from financial aid personnel is an important area to examine further.

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APPENDIX

Table 1 : Sample and Total Population Characteristics

	Sample		Population	
School Type	**Private(N=44)**	**Public (N=22)**	**Private(N=14,408)**	**Public (N=8,590)**
Gender (%)				
Male	26.0	47.6	47.0	40.0
Female	74.0	52.4	53.0	60.0
Average Age	21.8	24.5	20.6	26.0
Academic Level (%)				
Undergraduate	100	90.5	74.5	91.0
Graduate	0	9.5	25.5	9.0
Year in school (%)				
Freshman	25.7	4.8		
Sophomore	34.0	4.8		
Junior	24.4	23.8		
Senior	15.9	57.1		
Graduate	0	9.5		
Marital Status (%)				
Unmarried	89.4	73.3		
Married	10.6	26.3		
Pell Grants (%)			13.1	33.0

Source: U.S. Census Bureau (2010a and 2010b)

Table 2: Student Loan Products Comparison: National Commercial Banks versus Credit Union

Institution	Low Rate	High Rate	Average Rate	Term
Sallie Mae	3.38%	10.75%	7.06%	7-10 years
Citibank	3.63%	11.38%	7.5%	15-20 years
Chase	3.7%	9.55%	6.63%	20 years
Wells Fargo	4.5%	10.75%	7.63%	15 years
Credit Union	5.25%	9.25%	7.25%	15 years

Sources: Lenders' websites

Table 3: Students Loan Consumption by Gender

Consumption	Gender	N	Mean	SD	Levene's Test F	Sig(2-tailed)	T	df	Sig(2-tailed)
Used Student Loans	Male	21	0.00	0.000	0.508	***	-3.568	42	***
	Female	43	0.23	0.427					
Expect to Use Student Loans	Male	20	2.00	1.170	1.861		-2.106	48	*
	Female	30	2.83	1.487					
Likelihood to Purchase Experimental Student Loan Product	Male	21	56.90	30.671	0.019		0.917	60	
	Female	41	49.46	30.024					

† t test is independent samples test: * p<0.05;**p<0.01; ***p<0.001.

Table 4: Credit Union's Student Loan Consumption Intent by University Type

Consumption	School	N	Mean	SD	Levene's Test F	Sig(2-tailed)	T	df	Sig(2-tailed)
Used Student Loans	Private	24	0.29	0.464	30.533	***	2.301	33	*
	Public	21	0.05	0.218					
Expect to Use Student Loans	Private	18	3.11	1.491	1.393		3.148	34	**
	Public	18	1.78	1.003					
Likelihood to Purchase Experimental Student Loan Product	Private	24	64.57	18.486	27.162	***	2.576	27	*
	Public	20	42.05	35.447					

† t test is independent samples test: * p<0.05;**p<0.01; ***p<0.001.

Table 5: Product Features

Pairs	N	Mean	SD	T	df	Sig(2-tailed)
Low Interest Rate	65	4.80	0.642	5.153	64	***
Multiple Repayment Options	65	4.14	0.933			

Multiple Repayment Options	65	4.14	0.933	0.112	64	
Rate Discounts	65	4.12	0.927			
Rate Discounts	66	4.12	0.930	4.015	65	***
High or No Limits on Amount of Money Borrowed	66	3.60	1.154			

† t test is paired samples test: * p<0.05;**p<0.01; ***p<0.001.

Table 6: Logistic Regression Predicting Likelihood of Purchase of the Offer by Product Features

	Coeffi.	S.E.	
What do you like about offer: Length of Term	-18.795	7.286	**
What do you like about offer: Easy to understand	20.036	7.181	***
What do you dislike about offer: Extended Repayment Option	-43.796	19.294	*
Constant	53.778	5.729	***
R Square	0.25		
Number of Cases	54		

*p<.05 **p<.01 ***p<.001