

Statement of Michael Aamodt, Ph.D.
Principal Consultant
DCI Consulting Group, Inc.

I would like to thank the Commission for providing the opportunity to briefly discuss the validity of credit checks in the employee selection process. Let me begin by stating that I have no vested interest in whether organizations use credit checks; my purpose in testifying today is to provide an objective review on what we currently know about the validity of credit checks. My plan is to first discuss the potential reasons for using credit checks, then discuss potential adverse impact, and conclude with a summary of the small amount of research investigating the validity of credit checks in predicting employee performance.

On the basis of surveys conducted by the Society for Human Resource Management (SHRM, 2010), approximately 60% of organizations use credit checks when selecting employees for some jobs. Given this high degree of use, it is fair to conclude that many employers *believe* that credit checks provide useful information for certain jobs. From my discussions with employers, there are five common reasons why organizations use credit checks for employment purposes:

1. The organization is required by an external agency (e.g., a bonding company, a state government) to conduct credit checks. Thus, the employer is not using the credit check as a means to predict performance, but instead, as a means to fulfill a requirement by the bonding agency.
2. To reduce potential legal liability due to negligent hiring.
3. A belief that employees who are in financial distress might have an increased likelihood to steal or accept bribes. This is a common reason stated by law enforcement agencies for why they include a credit check as part of a comprehensive background investigation. I am not aware of any research on this topic that would support or refute this belief.
4. A bad credit history suggests that the applicant is irresponsible and is not conscientious and thus will be a bad employee. Employers relying on this belief are in essence, using a credit check to replace or enhance a personality inventory.
5. Employees with financial problems will be stressed due to the financial burden and thus will perform more poorly at work. There is some empirical support for this argument as meta-analyses have demonstrated statistically significant, but small, relationships between stress and work performance ($p = -.13$; Podsakoff, LePine, & LePine, 2007) and stress and organizational citizenship behaviors ($p = -.16$; Chang, Johnson, & Yang, 2007). There has also been research demonstrating that employees under financial stress have lessened job satisfaction (Bailey, Woodiel, Turner, & Young, 1998) and are more likely to miss work and spend work time trying to solve financial problems than are employees without such stress (Bagwell & Kim, 2003; Kim & Garman, 2004; Kim, Sorhaindo, & Garman, 2006).

Given this thinking, the question becomes: Are any of these reasons valid? Although there is considerable research that supports the use of credit scores in making *consumer* decisions, there is little research exploring the implications of using credit checks in employment decisions.

So, what do we know?

Adverse Impact

When looking at gender and race differences in credit scores, two large studies by the Federal Reserve System in 2003 and Freddie Mac in 2000 concluded that Asians and Whites have higher credit scores than do Hispanics and African Americans. From these findings we might conclude that adverse impact is likely to occur if we use credit checks for employment purposes. However, it is important to note that employment credit histories do not include a credit score and thus it may not be accurate to generalize findings from credit scores. Let me also note that we have clients that use credit checks that do not find adverse impact; a finding that can be at least partially explained by the notion that people with poor credit histories probably do not apply for positions in which they know a credit check will be conducted.

Validity

Is this potential adverse impact justified by business necessity? I could find only ten studies (5 related to credit history, 5 to self-reported financial problems) that correlated credit history/financial problems with counterproductive work behaviors (e.g., absenteeism, discipline problems). When these studies are combined using meta-analysis, the average uncorrected validity coefficient is .15; a level comparable to that found with personality inventories (Hurtz & Donovan, 2000). As shown in Table 1, financial problems seem to be correlated most highly with absenteeism ($r = .21$) and least highly with performance ratings ($r = .07$).

Table 1
Meta-Analysis Results

Criterion	K	N	r	90% Confidence Interval		SE%
				Lower	Upper	
Work problems	10	7,464	.149	.12	.17	57.24%
Discipline	5	5,946	.131	.11	.15	100%
Absenteeism	6	1,678	.211	.17	.25	100%
Performance ratings	3	561	.069	-.03	.17	48.01%

K = number of studies, N = total sample size, r = sample-size weighted uncorrected average correlation, SE% = percent of variability that would have been expected by sampling error

Where does this leave us? There is so little research on the topic that any conclusions would be premature. This lack of research is especially important to note because there have only been five studies that investigated actual credit history rather than self-reported levels of financial stress. Given the potential levels of racial/ethnic adverse impact as well

as the impact on individuals whose poor credit history is due to reasons often out of their control (e.g., divorce, illness), it would seem prudent for organizations using an applicant's credit history to do so in the context of a thorough background check that would indicate whether a poor credit history is an anomaly or is indicative of a problematic lifestyle that might impact behavior at work.

References

- Bagwell, D. C., & Kim, J. (2003). Financial stress, health status, and absenteeism in credit counseling clients. *Journal of Consumer Education, 21*, 50-58.
- Bailey, W. C., Woodiel, D. K., Turner, M. J., & Young, J. (1998). The relationship of financial stress to overall stress and satisfaction. *Personal Finances and Worker Productivity, 2*(2), 198-206.
- *Brennan, A. M., Davis, R. D., & Rostow, C. D. (2006). An investigation of biographical information as a predictor of employment termination among law enforcement officers. *Journal of Police and Criminal Psychology, 20*(2), 1-7.
- Chang, C. H., Johnson, R. E., & Yang, L. Q. (2007). Emotional strain and organizational citizenship behaviors: A meta-analysis and review. *Work & Stress, 21*(4), 312-332.
- *Dibb, G. S. (1978) *A cross-validated comparison of models for the prediction of academy performance and job tenure of police officer recruits*. Unpublished doctoral dissertation, University of Hawaii, Honolulu.
- *Hendrix, W. J., Steel, R. P., & Shultz, S. A. (1987). Job stress and life stress: Their causes and consequences. *Journal of Social Behavior and Personality, 2*(3), 291-302.
- Hurtz, G. M., & Donovan, J. J. (2000). Personality and job performance: The Big Five revisited. *Journal of Applied Psychology, 85*(6), 869-879.
- *Joo, S. (1998). *Personal financial wellness and worker job productivity*. Unpublished doctoral dissertation, Blacksburg: Virginia Polytechnic Institute & State University.
- *Kim, J., & Garman, E. T. (2003). Financial stress and absenteeism: An empirically derived research model. *Financial Counseling and Planning, 14*(1), 31-42.
- *Kim, J., & Garman, E. T. (2004). Financial stress, pay satisfaction, and work performance. *Compensation and Benefits Review, 36*(1), 69-76.
- Kim, J., Sorhaindo, B., & Garman, E. T. (2006). Relationship between financial stress and workplace absenteeism of credit counseling clients. *Journal of Family and Economic Issues, 27*(3), 458-478.
- *Matyas, G. S. (1980). *The relationship of MMPI and biographical data to police performance*. Unpublished doctoral dissertation, University of Missouri – Columbia.
- Nielsen, M. L., & Kuhn, K. M. (2009). Late payments and leery applicants: Credit checks as a selection test. *Employee Responsibilities and Rights Journal, 21*(2), 115-130.
- *Oppler, E. S., Lyons, B. D., Ricks, D. A., & Oppler, S. H. (2008). The relationship between financial history and counterproductive work behavior. *International Journal of Selection and Assessment, 16*(4), 416-420.
- Palmer, J. K., & Koppes, L. L. (2003, May). *Further investigation of credit history as a predictor of employee turnover*. Poster presented at the 15th annual convention of the American Psychological Society, Atlanta, GA.
- *Palmer, J. K., & Koppes, L. L. (2004). *Investigation of credit history validity at predicting performance and turnover*. Presented at the annual meeting of the Society for Industrial and Organizational Psychology, Chicago, IL.

Podsakoff, N. P., LePine, J. A., & LePine, M. (2007). Differential challenge stressor-hindrance stressor relationships with job attitudes, turnover intentions, turnover, and withdrawal behavior: A meta-analysis. *Journal of Applied Psychology*, 92(2), 438–454.

*Prawitz, A. D., Haynes, G., Garman, E. T., Shatwell, P., Hanson, K. C., & Hanson, E. W. (2010). Employee financial distress, emotional health risk, and absenteeism. *Proceedings of the 2010 Annual Eastern Family Economics/Resource Management Conference*, 4-6.

* Study was used in the meta-analysis