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SIOP Member's Research Shows That Integrity Tests Can Help Banks Assess Risk and Employers Assess Applicants

By Stephany Schings Below, Communications Manager

Banks commonly use credit checks and scores to help assess the risk of loan applicants, but what is a bank to do when they don't have access to credit information? In helping find a solution to lack of credit history for loan applicants in third world countries, one SIOP member shows that integrity tests may be used to assess the risk of credit applicants — and could also replace controversial credit checks performed by employers.

Risk management assessments such as integrity tests have most commonly been used for preemployment selection to screen out applicants likely to engage in counterproductive work behaviors (CWB), whereas credit history or credit checks have most commonly been used to help financial institutions make decisions about lending money and extending credit, explained SIOP Member **Kelly Dages**, a senior organizational psychologist at Vangent, Inc., a global provider of information management and strategic business process outsourcing services. However, many organizations are using credit checks as part of the preemployment selection process to measure applicants' reliability, stability, and likelihood to engage in CWB.

Dages says integrity tests, which are designed to directly assess attitudes regarding dishonest, unethical behaviors, may provide a cost-effective and valid alternative. The results of her recent research involving two empirical studies on integrity tests developed at Vangent suggests that integrity tests may provide an alternative to credit checks assessing risk in lending applications and that they may be a less controversial option for employers looking to assess integrity, ethics and responsibility in applicants.

Dages will present her findings in a poster at the 26th Annual SIOP Conference **April 14-16** in Chicago. To attend this poster session, as well as choose from hundreds of other engaging sessions, register for the annual conference today!

Dages' research started in 2007 with the Entrepreneurial Finance Lab (EFL), part of the Harvard Center for International Development, which is home to research into the impact of psychometric tools on access to finance, entrepreneurial training and skills, and experimental alternative financial contracts. (In 2010, the Entrepreneurial Finance Lab became an independent private organization.)

"Basically they have a project where they are building an assessment battery for screening small business entrepreneurs in third world countries to increase their access to finances," Dages explained. "The lenders are looking for information to evaluate creditworthiness and usually credit history is not available—a lot of times these people do not have a credit history or the country's banking system is not organized enough to keep these records. To do an in depth review is costly, and the Entrepreneurial Finance Lab wanted to do something that would be more efficient and less costly to review."

Dages explained that some lending institutions in third world countries may have little information to assess an applicant's credit risk.

"In many of the third world countries, a lot of the people there especially small business owners, just don't have a credit history, because they have so little income and money that they don't need a bank," she said. "There's no credit history for them to go back and say 'you bought this car' or 'you have this credit card' because they don't have this type of resource. EFL was looking for a way to help those people begin to better support themselves."

So the lab turned to Vangent to help build a tool that could be used by banks and venture capitalists for screening small business entrepreneurs in developing countries. What Vangent developed was the Vangent Credit Assessment Risk Evaluation (V-CARE) and V-CARE Express that provide application-specific assessments of integrity. Through two studies, Dages and her team at Vangent found that the integrity screening V-CARE and V-CARE Express provides may serve as an integral component of EFL's assessment process to screen out high credit risks. This first study presented preliminary analyses evaluating the relationship between an integrity test and credit-related criteria with a South African sample of small business entrepreneurs.

"What we essentially found was that there is a significant relationship between the V-CARE assessment scores and a group of venture capitalists' ratings of these loan applicants," Dages explained. "Additionally, it was significantly related to whether the person had written bad checks in the past or not, and that relationship was that people who had written bad checks scored significantly lower on the V-CARE assessments. Applicants who were ultimately approved for their loan status scored higher on the assessment than those who were declined or dropped out of their applications."

Throughout 2009 and early 2010, EFL completed a second pilot study with V-CARE in developing countries across Africa and Latin America (Kenya, Rwanda, Peru, and Columbia). A total of 2,085 loan applicants completed V-CARE either via paper or computer, depending on technology available.

"Before we started the second study we made some revisions to the assessment, for a shorter and more focused assessment," Dages explained. "We didn't have venture capitalist ratings with this study, but we did have actual loan default statistics from after an applicant received a loan. Not only was it a larger sample size and more representation from other countries, but we also have more direct criteria of the outcome of the loan default."

That direct criteria supported Dages' earlier findings.

"We found a significant relationship between the V-CARE scores and whether the applicants defaulted on the loan," Dages said. "We also looked at the relationship of the V-CARE assessment with applicants' theft admissions and found a significant relationship, whereas people with high-risk attitudes on this integrity assessment were also more likely to have engaged in and to have admitted to some type of theft or other such behavior in the past."

In addition, EFL research found that the psychometric tools, including V-CARE, are as accurate, if not more accurate, than the due diligence that some of the third world lending institutions were having to do before the integrity test and other tools were implemented when they lacked credit information, Dages added.

"We don't necessarily recommend that the integrity test be used on its own without any other information," she explained. "But this certainly helps to predict loan applicants' risk when it comes to whether they might default on a loan because of being dishonest or being irresponsible. These banking institutions might not have necessarily had a credit score available, but the type of research and interviews and the process they were going through before the integrity test and other psychometric tools came about is much more costly and this test is estimated to be less than 10% of the cost that they were incurring before and just as accurate."

Dages said this accuracy stems from the common characteristics found in people with low integrity and those more likely to default on loans.

"I think dishonest people are more likely to default because they are more likely to engage in unethical behaviors that involve lying and theft and they may not care if they don't repay a loan," Dages said. "If you take a loan and you don't pay it back, essentially you're stealing that money. Someone who doesn't have the integrity to say 'this is my responsibility to try to pay it back as best I can' is not going to be as concerned about defaulting on a loan."

That logic is what Dages thinks could make her research applicable to organizations in the U.S. who do have access to credit checks for potential employees but who may not necessarily need to use them. Based on validity of V-CARE for measuring credit risk, existing validity of integrity tests as a preemployment selection tool, and criticisms of credit checks, integrity tests may be a more suitable option for employers than credit checks, Dages explained in her poster.

"One of the impetuses for us wanting to submit this research to the SIOP Conference was recent scrutiny and legislation around employers using credit checks. We are recommending that integrity tests could be a better alternative to credit checks used especially by employers and that the idea that integrity tests are valid and psychometrically sound actually aligns with years of research on assessments as far as measures of theft and counterproductive work behavior. Really part of the logic or thought was that if we have financial institutions using integrity tests for loan applicants, then why do we have employers using credit checks for their employees?"

Recent data from the Research Department at the Society for Human Resource Management (SHRM) shows that 6 out of 10 employers conduct credit checks on job applicants. Although only13% of organizations surveyed conduct credit checks on all job candidates, another 47% consider credit history for candidates of select jobs. For those jobs with financial or fiduciary responsibilities, 91% of employers conduct checks, and 46% use credit checks for senior executive positions.

But widespread use of credit checks doesn't mean they are without controversy.

"There has been a lot of backlash against credit checks in the media recently, and there has been some legislation outlawing the use of credit checks on job applicants for many positions in several states. Illinois is one of them," Dages explained. "There has been some legislation against credit checks in other states as well."

According to Dages, reasons employers may want to find alternatives for credit checks in their pre-employment screening process include (a) applicants often feel that credit checks are an invasion of privacy, (b) internationally credit history is not always available, (c) application is inconsistent, (d) validity evidence is limited, and (e) legal restrictions apply.

"Credit history may be viewed as an objective source of information compared to an attitude and behavior self-assessment," Dages explained. "However, there may be mistakes in the credit reports or the applicants may have lied on credit applications. Also, there is not an objective industry standard for what is considered acceptable credit history for preemployment screening. Therefore, the use of credit history to evaluate an applicant may still be a subjective measure."

A lot of the time, the logic for using credit checks is actually the same for integrity tests, Dages explained.

"Employers think the candidate is going to be more likely or tempted to steal if they have a bad rating," Dages explained. "But the credit checks are actually getting at that information indirectly because they aren't actually measuring job-related criteria, whereas integrity testing is application relevant. The test may ask about a person's attitudes or motivations as far as being reliable or dependable in job situations versus just showing that somebody was 60 days late on a bill, which doesn't necessarily tell you what their motive or attitudes are. I think some employers think using a credit check is much more objective than using a psychological assessment, but you have issues with reliability and accuracy with credit checks. So just because it gives you some number or it gives you a history of how they met their financial obligations doesn't necessarily mean that it's accurate."

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