

Access to Credit on a Low Income

A research project by Liverpool John Moores University

Initiated by

The COOPERATIVE BANK

Executive Summary

“The Government’s decision to overhaul the Consumer Credit Act has put the issue of consumer credit and debt high on the national agenda.

“While most reaction to the announcement has focused on the seemingly never-ending supply of credit to the mainstream consumer, this report looks at the limited choices available to millions of families on low incomes.

“It has wide-ranging recommendations for regulators and credit providers. For our part, it has convinced us of the need to redouble our efforts to support and develop the credit union movement in the UK to better serve this group.”

Simon Williams, Director of Corporate Affairs
The Co-operative Bank

INTRODUCTION

Ready and immediate access to credit has led Britain into a lending boom. Consumer debt is at record levels and a seemingly endless supply of easy credit is available through store cards, credit cards, loans, overdrafts and hire purchase schemes.

Britain's financially excluded have a different story to tell. For the millions who are at the margins of society, mainstream credit is very often not an option. Extra money to finance basic needs like furniture or children's clothing comes instead from a flourishing alternative lending market encompassing everything from mail order catalogues and home credit to pawn shops, tontines* and, as a last resort, unlicensed money lenders.

This qualitative research study explores why and how people on low incomes access and use credit facilities. It aimed to deepen our understanding of the financial choices of low-income consumers and in so doing to inform policy-makers and credit providers in the future development of credit regulation and services.

BACKGROUND

The roots of the study lie with the Furniture Resource Centre in Liverpool, a social business which manufactures and recycles furniture primarily for low income groups. Its city centre Revive store is looking to establish an innovative credit union which would allow it to provide low-cost credit facilities for its customers. Currently, lack of credit facilities means many customers cannot buy the store's low-cost products and opt instead for high-cost credit purchases through catalogues or other retail stores.

A group of partners came together to explore the issue, including the Furniture Resource Centre, The Co-operative Bank - banker to 60% of UK credit unions - Liverpool John Moores University, and local housing associations and citizens advice bureaux. Discussions pinpointed a need for a greater understanding of how people on low incomes in Liverpool accessed credit, and what factors influenced the choices they made. As a result, the Bank commissioned Paul Jones, of Liverpool John Moores University, to undertake a local study.

Methodology

The research was conducted through a mixture of one-to-one interviews and focus groups with 59 people on low incomes in Liverpool. Participants represented a number of social groupings (lone parents, unemployed, low income employed, sick/disabled, pensioners), with the largest single group of participants being 20-35-year-old lone parents.

AN OVERVIEW

Although previous research[#] has shown that financially excluded households do not prioritise 'credit' as a financial product to which they would like access, it is clear from this study that in fact obtaining credit is an essential part of everyday life for people on low incomes.

Ninety per cent of participants said they needed to borrow money not only to buy essential items, but also to make ends meet. People regularly borrowed to pay bills, to buy clothes and school uniforms, and for birthdays, holidays and Christmas - often out of sheer desperation.

Some said they did not use credit facilities at all. They were in fact regularly using catalogues and pawn shops, but did not perceive these as sources of credit.

A small minority were opposed to borrowing per se, and a significant minority found accessing any sort of credit very difficult - rejected because they were not earning, had a poor credit history, or lived in a blacklisted area.

* an informal savings club organised among groups of family/friends, in which the pool of savings is usually rotated among the participants

Kempson and Whyley, 1999 (Kept or opted out? Understanding and combating financial exclusion)

SOURCES OF CREDIT

The majority of participants did not use banks or mainstream credit providers (“People around here don’t deal with banks, they are not for us”) - instead using a range of alternative sources. These included:

- **Mail-order catalogues** (sample APR 28.8%) The most popular form of credit among participants, and regularly used to buy larger household items and clothes. While people knew they could be expensive to use, they offered easily available credit, manageable weekly instalments and the convenience of doorstep delivery. Catalogues were also viewed as an acceptable form of borrowing, with no stigma attached.
- **Home credit** (sample APRs from 164% to 903%) This form of “doorstep lending” has a long history in Liverpool, and familiarity with home credit has been passed from generation to generation. “The Provy* has been going for years. My mother passed it on to me...my mother always said have a Provy cheque in your purse as there might be a sale on.”

While participants appreciated the accessibility and convenience of home credit, many regarded it as an expensive option which could lead people into a never-ending cycle of debt. Some reported feeling under emotional pressure to borrow more because of their often close relationship with the collector.
- **Pawn shops/buyback stores** (sample APR 67.27%) A ready source of instant cash, these were used by a significant number of participants, and there was local evidence that these are growing in popularity in Liverpool. “It’s at your Uncle’s” is a phrase that is resurfacing in local households.
- **Cheque cashing centres** (sample charge: 10% of cheque value) These centres offer credit by giving cash now for a cheque cleared later and were a popular source of easy and accessible short-term credit for those with bank accounts. One participant - a single parent - had paid her way through university by borrowing in this way.
- **Retail shops** (sample APR 29.9%) All participants knew of stores which allow customers to buy items on weekly credit with no credit checks. While many were attracted by the easy availability of credit and some had used these facilities, most were reluctant to use such services - aware of the high cost of the credit and the risk of repossession if payments were not kept up.
- Borrowing from **family and friends** was widespread, and underlined the strong network of social and family ties in the areas where the participants lived.
- People were well aware of the existence of **unlicensed money lenders** but very few admitted to borrowing from them. While there was evidence of violence and intimidation from the stereotypical hard men, many lenders were in fact local women lending small amounts against the security of benefit books.
- **Social Fund** loans were commonly used and generally well regarded, although some people were put off by the lack of control over the level of the loan and the repayments.
- **Tontines** (“the tonnie”) Many participants had been members of these informal savings clubs organised among groups of family/friends, and said they were still common.
- **Credit Unions** Very few of the participants were members of credit unions, although most knew of their existence and recognised them as a good way to save and an affordable way to borrow. However, they were perceived by many as poor person’s banks (“Only poor people go to loan sharks and only poor people go to credit unions.”) and there was a perception that their services were too limited.

MAKING CHOICES

Although the credit options open to people on low incomes are limited, it was clear from the research that choices were still being made, based on a wide variety of preferences, assumptions and beliefs.

By far the most important factor in choosing a source of credit was **accessibility** - "It's who will not say no to a loan that matters".

People turned to sources where they knew the answer would be yes - used to being turned down for loans, or assuming they would be.

Ease and flexibility of repayment was another important influencing factor - repayments needed to be affordable in the context of very tight household budgets, with the flexibility to be able to miss the occasional payment in difficult circumstances.

In a context of necessity and few options, the overall cost of the credit itself was often not directly taken into account. "Cost of credit is not important when money is needed straight away, most people do not understand APR".

Affordability was judged not by the total cost of the credit but much more by the level of the weekly repayments. While people were aware that they were often being charged high rates for borrowing, the priority was obtaining a loan to meet an immediate need.

Tradition and culture was in fact a very important influencer. Credit services that were seen as traditional and part of the community were far more acceptable than those that were not; nobody spoke of being stigmatised as poor by using home credit, but many did so when speaking of credit unions.

CONCLUSIONS AND RECOMMENDATIONS

This study revealed a world in which the vast majority of people on low incomes were borrowing money regularly for essential items and to make ends meet. Accustomed to being turned down elsewhere, many people readily and even willingly accepted credit from alternative lenders. But they did so at a price - a price not just measured by high and often extortionate interest charges and unfavourable terms and conditions, but by being caught in a never-ending cycle of borrowing and debt.

Key recommendations - to national and local government, the Financial Services Authority, banks and credit providers - are:

- **Recognition.** There needs to be both national and local recognition that access to credit is a major issue in the lives of people on low incomes. Local and regional economic development strategies should take into account the needs of this group of consumers, and the impact of alternative lenders on their communities.
- **Regulation.** The reform of the Consumer Credit Act 1974 must: tackle the high and often extortionate charges made on loans to low income consumers; ensure transparency and clarity of information relating to the cost, terms and conditions of loans; enable courts to reset interest and other charges on a loan without the request of the debtor; require lenders to assess the capacity of borrowers to repay a loan.
- **Credit Unions.** To reach larger numbers of low-income consumers, credit unions need to become more professional, market-orientated financial institutions. Support must come from central and local government, housing associations, banks and other credit providers. The Financial Services Authority should develop more flexible interpretations of the 'common bond' (field of membership of a credit union), to allow these organisations to reach greater numbers of low-income consumers.