

# Would you credit it?

People telling stories about credit



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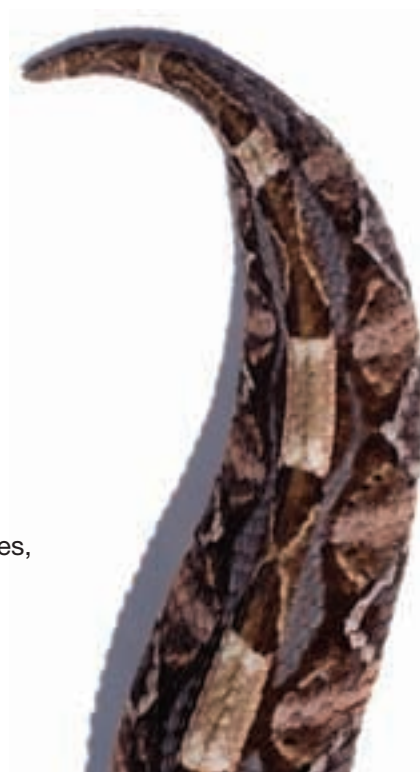
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# Foreword



## Would you credit it?

### People telling stories about credit

It's over three years since our first report, *Access to Credit on a Low Income*, lifted the lid on the realities of how households borrow money in a poor neighbourhood. We wanted to return to the issue, and to look wider (geographically) and deeper (in the issues involved) –

particularly to examine the importance of financial literacy in such households.

There are so many financial products nowadays that many people feel swamped with information and unable to make an informed decision. *“Would you credit it?”* focuses on how people who are on low incomes, and are often over indebted, understand and learn about the terms, conditions and cost of the credit they choose. Evidence shows that lack of knowledge plays a contributing part in increasing levels of debt and poverty. The findings in this report have arisen, for the most part, from 43 people telling their own stories in a series of focus groups throughout Britain, about the credit they use. The research also included 315 low income consumers who responded to a quantitative survey distributed by an independent market research company through money advice agencies, citizens advice bureaux, credit unions and registered social landlords across England, Scotland and Wales. It reveals more about borrowing and consumer debt in low income communities and raises questions about the impact of low levels of financial literacy within low income communities. The lack of understanding of the cost of borrowing in low income communities is of particular concern in this report.

In recent years, enhancing financial literacy and improving financial capability have become key government initiatives to help people better understand and manage their finances and thereby become less vulnerable consumers. Underpinning these initiatives is the belief that education and the provision of information can change and improve a person's financial situation. Within a low income community, this report argues that enhancing financial literacy is a particular challenge. Not only does it seem to require both financial advice and personal support, it also involves assisting people to access more affordable credit alternatives where they exist.

It is in the interests of society as a whole to improve consumer financial capability. We support government and FSA initiatives to promote financial capability. However these findings demonstrate the need to prioritise and direct resources to those parts of society that are clearly the most vulnerable.

Sheila Macdonald, Chief Operating Officer, The Co-operative Bank

# 1. Background to the research

The research report, “*Access to Credit on a Low Income*”, commissioned by The Co-operative Bank in 2001, highlighted the importance of credit in the lives of people on very low incomes. Neither comfortable, nor confident, in using mainstream financial services, the report revealed how people turned to a range of alternative lenders to finance basic needs. It explored the world of pawnbrokers and cheque cashers, buyback stores and weekly repayment retail shops, catalogues and home credit companies and the way people used those lenders in their struggle to provide for their families and make ends meet. The report focused on the choices people make in accessing alternative credit, and the reasons that lay behind those choices.

People have no option but to pay extortionate costs for small loans.



In times of need, and when few options are available, people choose to borrow from high cost lenders primarily because the loan is immediately available, application is easy and straightforward and the weekly repayments are perceived to be affordable within a weekly budget. Familiarity and feeling comfortable with the lender and the product are important too. Significantly, the overall cost of the loan is not important when there is an immediate need to raise cash. Out of necessity, people have no option but to pay extortionate costs for small loans which can, and often do, lead to over indebtedness and increasing poverty. As Teresa Perchard, Director of Policy for Citizens Advice said: “...*the reality of the debt situation in the UK is that millions of people have debts that they either cannot cope with, or can only just keep under control*”. (Citizens Advice 2004.)

Understanding the reasons that lie behind the choices people make is important. But so too is understanding what people understand about the terms and conditions of the credit they use. People can choose credit out of necessity without knowing or understanding fully the terms, conditions or the costs

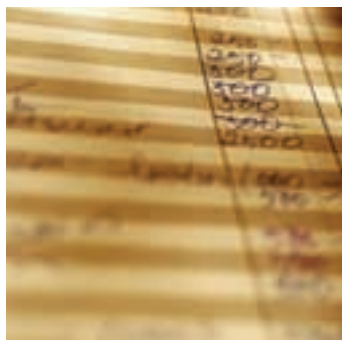
involved. This can lead to people being trapped in credit agreements that are not in their best interests or facing spiralling costs. An East of Scotland CAB reported on a disabled client in receipt of benefit who had obtained a credit card despite her low income. After missing one payment and exceeding the limit on the credit card, she accrued monthly charges and interest that quadrupled her original borrowing (Citizens Advice Scotland 2004). This new research project “*Would you credit it?*” focuses on how people understand and learn about the terms, conditions and cost of the credit they choose. Importantly, the findings in this report have arisen from 43 people telling their own stories about the credit they use in a series of focus groups, and from 315 low income consumers

completing a questionnaire distributed through community based organisations in England, Scotland and Wales. Both in scope and rigour, this research expands upon the previous 2001 findings. It reveals more about borrowing and consumer debt in low income communities and raises questions about the impact and extent of financial illiteracy within low income communities. A recent Institute of Financial Services report noted that eight in ten (79%) of the population did not identify the term APR as the interest rate (IFS 2004). The lack of understanding of the cost of borrowing in low income communities is of particular concern in this report.

In recent years, enhancing financial literacy and improving financial capability have become key government initiatives to help people better understand and manage their finances and thereby become less vulnerable consumers. Underpinning these initiatives is the belief that education and the provision of information can change and improve a person's financial situation.

**The lack of understanding of the cost of borrowing in low income communities is of particular concern in this report.**

Within a low income community, this report argues that enhancing financial literacy is much more complex. Not only does it involve much greater financial advice and personal support, it involves assisting people to access more affordable credit alternatives.



## 2. Research methodology

### Research aims and hypothesis

The research study aims to explore how people on low incomes access and use credit. It aims to identify how people learn about the use of credit, about where they obtain information and about how they understand the terms and conditions of the credit they use. A particular aim is to investigate the effects that low levels of financial literacy have on low income consumers.

The hypothesis of the research is that despite efforts of government and money advice agencies, people on low incomes remain dependent on alternative credit providers without being fully aware of the terms and conditions of the credit that they are accessing through that sector.

### Research methods

The research study was designed to allow people to tell their own stories of obtaining credit from alternative lenders. It aimed to be a collaborative research project involving low income consumers in a participative inquiry. The key element of the methodology was a series of focus groups organised in five locations throughout Britain. A secondary element of the methodology was a national survey distributed through citizens advice bureaux, credit unions and community organisations. The findings were debated with a professional money advisor focus group before publication (see Appendix II).

## 3. People telling stories about credit

The focus groups, in Liverpool, Wythenshawe, Barry, Cumnock and Ladywood, were designed to allow people to tell their own stories of living on a low income and obtaining credit from alternative lenders. Participants told personal and vivid stories of learning about the use of credit, about any changes they made in their borrowing as a result of their learning, about how they obtained information and how they understood the terms and conditions of the credit they used. A strong culture of story telling based on personal experience was in evidence in all focus groups.

### Learning about credit

#### Story telling

In all the groups, education and knowledge about the use of alternative credit was first gained through the social networks of family and friends within the community. A fact confirmed in recent research by the National Institute for Economic and Social Research, which maintained that people's reliance on social networks was the causal reason behind one in ten people lacking access to mainstream financial services.

The importance of social networks is well illustrated in the following quotation from a young single woman in the Liverpool group:

*"It (the use of home credit) was just something you automatically did because your mother done it, and so you did it."*

*"When you are desperate, you just use it (home credit) don't you, there are no credit checks and you think that is okay, great, so you go and use it, you are desperate, and you just get in more and more debt",* a young woman in Ladywood noted, referring to how her family, friends and herself use home credit.

Young people can take their first steps into alternative lending through the influence of family and friends.

For example, a family member may take out a loan on behalf of a young person who then repays the family member who is held legally responsible for the loan.

*"I was 16 when I had my first Provvy loan, I bought jewellery first from them, but later I got desperate in debt because I used the Provvy",* young woman in the Ladywood focus group.

In a community, stories told about credit can bind customer loyalty to alternative lenders. The use of home credit, for example, on estates in Liverpool has persisted from one generation to the next. This dynamic arises out of necessity and a lack of affordable alternatives, but can, in many cases, contribute to a cycle of poverty and over indebtedness in later life. Through people telling stories and sharing information, people learn how alternative lenders operate and how to get a loan.

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In most of the focus groups, mail order catalogues were the most used and a favourite source of obtaining goods on credit. They were seen as a cheaper option and valued for their weekly terms and flexible conditions. *“They are forever doing special offers”*, said one young woman in Ladywood. Families and friends exchange information about offers and often a mail order catalogue, held by one person, becomes a catalyst of a small social network as people purchase goods through the catalogue agent.

**“You get £50 or £60 for something and you pay back £15 to £20 on it when you go back”.**

In the Wythenshawe focus group, young men shared stories about using the local “Cash Generator” shop. In fact, the national survey confirmed the popularity of these buyback stores among young men. It revealed that 53% of those using buyback stores were male, 41% of whom were under 25. The young men were able to sell goods to the store, with the possibility of redeeming the items later within a 28 day period. *“It’s a real handy place”*, said one of the young men in Wythenshawe, *“they will take anything, even a second hand deep fat fryer”*. Stories abounded of quickly getting hold of ready cash and being able to buy back the goods at a later date. Interestingly, none of the stories included the high cost of the buyback deal. In fact, it was seen as good value. *“You get £50 or £60 for something and you pay back £15 to £20 on it when you go back”*, said one young man. The actual cost over a 28 day period was not calculated. What mattered was being able to obtain a “loan” when needed. *“You don’t even need to go back”*, he explained. The amount allocated on the goods is always much less than their value. Failure to return and buy back the item means that people on low incomes are losing the small amount of assets they may own. In the national survey, 35% of those using buyback stores failed to buy back the item. Among women in Ladywood, stories about the value and popularity of pawnbrokers were more prevalent. The national survey confirmed high use of pawnbrokers by women. 58% of those using pawnbrokers were found to be female. Pawnbrokers are used to obtain ready and instant cash by pledging jewellery to be used as security. As one of the Ladywood women explained, it was often safer to keep her jewellery in the pawnbrokers, and pay the regular fee to keep it there, as it prevented it from being stolen. This is a by-product of people on low incomes not having household insurance.

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Even the Social Fund was the subject of story telling. *“You have to lie to get what you want, you have to ask for double”*, said one woman. How to fill in forms was often the discussion among the women with one or two being experts in form filling and communicating their knowledge to others: an example of people helping people in times of need. And, in Cumnock, knowledge of how to access unauthorised money lenders was passed on by word of mouth through local social networks. In Cumnock, where many of the traditional alternative lenders are absent, unauthorised money lending was much more prevalent.

Much practical understanding of how the alternative credit market works is gained through personal and social contact within the community. Most members of the groups understood well the practical workings of catalogues, buyback stores, home credit, pawnbrokers and so on. However, there was an important downside to this way of communicating information. Knowledge could be informed, or rather misinformed, by myths and unrealities. Opinions and prejudices were held that potentially acted against people’s own interests.

**In Cumnock, where many of the traditional alternative lenders are absent, unauthorised money lending was much more prevalent.**

The strength of myths came through the focus groups in a number of ways. Home credit was sometimes regarded as inexpensive because it was used for years by family members. As one CAB worker in Liverpool noted, *“common myths are very strongly held, regardless of contrary information, education and training provided”*. Unauthorised lending is also subject to myth. *“Unauthorised lenders are more extensive than people know”*, she reported, *“there is a belief that because there are no signed loan agreements, people think they are getting a good deal”*. There were certainly myths and uncertainties about what happened in the case of missed payments and default on a loan.

Myths abounded about the rights of bailiffs, including this more humorous example from a man in the Liverpool focus group:

*“They can only take goods amounting to the value of the debt. I don’t know whether this is a true story but I heard that a bailiff came round to this woman’s house to collect a debt of £2.78 so she gave him a sock and a broken mug.”*

Meadows, Ormerod and Cook (2004), in research conducted for The National Institute for Economic and Social Research, argued that the reliance on social networks for information was the causal reason for people being unable to access mainstream financial services. The argument ran that because people obtained their information from family and friends, and that this information was often inadequate and incomplete, it was this gap in information that prevented people accessing mainstream financial services. In other words, financial exclusion was the result of information failure rather than market failure.

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This was not the experience of the people in the research focus groups. For the most part, and for a variety of reasons, they could not, and did not, access mainstream financial services. They had no choice but to use high cost lenders and were unable to access credit at reasonable and affordable rates. In the alternative credit market, competition did not exist to drive down the cost of credit for consumers to any significant extent. This point has been argued by Regan and Paxton (2003) who stress that *“there is a clear market failure resulting in a lack of affordable credit for many people on low incomes”*. Whyley and Brooker (2004) explore the realities of this market failure in relation to home credit where they identify *“captive customers”* who have few other options for meeting their credit needs.

### Learning from personal experience

Many group participants, through necessity and a lack of affordable options, used alternative lenders regularly. They used home credit, catalogues, buyback stores, and even unauthorised money lenders. However, some reported how they had been able to change their borrowing patterns over time. They had suffered difficulties in the past from over indebtedness to alternative lenders, or they were closely aware of, family and friends that had severe debt problems. Some reported that they had been able to reflect on their personal experience and resist borrowing from alternative lenders. But this was not easy when there were few other options. However, a number of factors were identified that assisted people to break out of using high interest lenders; changing circumstances, money advice support, and, most importantly, the availability of alternative affordable options. In the case of Ladywood, for example, the opportunity to join the local credit union in the community centre made the most significant difference to those who had joined.

**Some were now strongly averse to using home credit due to personal experience of debt.**

Many of the women spoke of how they got into debt with home credit companies and catalogues when they were young single mothers and how it took them many years to realise the impact on their lives of such borrowing. Some were now strongly averse to using home credit due to personal experience of debt. Those that were able to make a change in their borrowing patterns attributed it to learning from their own mistakes or those of others. In many cases the ability to avoid using alternative lenders was linked with women becoming more assertive in their own lives.

*“Living the experience, having the experience, makes you think what is going on, it took me years, about 10 years, borrowing on home credit and others, it took a long time, but I was glad in the end that I knew what was going on”,* said one Ladywood female participant.

One woman in the Cumnock focus group told the following story that influenced her to avoid unauthorised moneylenders. In Cumnock, where many of the more common alternative lenders are absent, there is a significant incidence of unauthorised money lending.

*“There was one woman in here who had got a loan of £300 and she came into the community centre office crying one day. She told me that she had got to pay and as usual there was a bit of a threat there. I don’t know where the lender got the money as he had never worked a day in his life but he got his money through beating people up.*

*He weren’t that big, so maybe he was going to get someone else to do it, I don’t know. But I actually lent her £20*



*because she now owed £500 and she was only behind by about four weeks or so. She was being threatened because she couldn’t make the payments. They were talking about letting her man know about the debt”.*

Interestingly, in Scotland, significant learning from experience occurred when participants took part in education campaigns at the time of the protests against the introduction of the poll tax. *“During the Poll Tax protests in the early nineties”,* one woman related, *“the Council employed companies to recover unpaid poll tax. The tactics they used to collect the money was as bad as the moneylenders”.*

This experience led many to understand the recovery powers of bailiffs and other debt collection agencies in much greater detail. An important learning experience given that a recent Citizens Advice Scotland report noted that one in six clients had been threatened with unlawful debt recovery methods (CAS 2004). The national survey also revealed an incidence of a changed attitude to lending by some respondents. Of respondents replying that they would not use home credit

again, 88% were women. Reasons given were that there were too many hidden charges, that it was too expensive and that the lender did not understand the borrower’s situation when a payment was missed.

## Finding out about credit

There was little evidence in the focus groups of people reading and gaining information from leaflets or other printed promotional materials. A focus group exercise involved reviewing leaflets. *“I don’t read leaflets”,* was the typical reply from the majority of participants.

This was confirmed in the national survey where 50% of respondents preferred direct personal one-to-one contact in order to obtain information about financial services in comparison with just 11% who preferred leaflets, 18% preferred newspapers or magazines and 13% the television. In the groups, people stated that they found out

**88%**  
of respondents replying that they would not use home credit again, were women.

information by word of mouth. Human contact was the clear, preferred option.

In Ladywood, those who were members of the credit union were asked what influenced them to join. They replied that they were told by, or heard about it, from family and friends who were members or through children who were already junior members. There was no mention of printed information. The same point was illustrated by a financial literacy worker in Liverpool who observed that *“when we look at forms of credit in workshops, occasionally people will say ‘credit union’ – but they always have family who are members or volunteers in them, it’s hardly regarded as an option otherwise”*.

**Group members reacted to the printed leaflets with comments based on their personal experience, existing prejudices and knowledge rather than the printed material in front of them.**

The focus groups included an exercise on reviewing printed leaflets and publicity materials. Group members were required to comment on and assess leaflets from two different alternative lenders: Cash Generators and BrightHouse. In general, group members reacted to the printed leaflets with comments based on their personal experience, existing prejudices and knowledge rather than the printed material in front of them.

Interestingly, however, in Wythenshawe, the Cash Generator’s leaflet was preferred over the BrightHouse leaflet as it did not have small print and was therefore regarded as being more honest and up front. In fact, in the small print, the BrightHouse leaflet actually provided an illustrative example that included more substantive and detailed information on the cost of a loan. There seemed to be an inherent distrust of small print which was not read, nor referred to.

In Ladywood, some of the group members found the budgeting information requested on some of the leaflets to be particularly confusing. Information was requested on items that do not usually apply to low income people (endowments, pensions, life assurance etc) and this immediately alienated the group from the leaflet. They said they would much prefer just to know the costs involved.

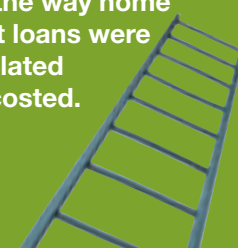
## Understanding terms and conditions

It was clear in the groups that participants preferred terms and conditions that were simple to understand. However, individual experience of the terms and conditions of alternative lenders was not always experienced as straightforward.

*“When loans (home credit) are topped up, they don’t explain it, they write it down*

*but it is difficult to understand, it’s so complex but you just go along with it when you need the money. The amount of money they put on top is ridiculous, you end up in so much debt just wanting to have a nice home”*, Ladywood participant.

**Group participants were often confused with the way home credit loans were calculated and costed.**



In general, group participants were often confused with the way home credit loans were calculated and costed. It was not always completely transparent in a way that people could easily understand. A particular problem was that of just making a minimum repayment on a loan, as the following group participant noted:

*“I first started with home credit, someone knocked at the door selling towels – it was £100 for some towels, so I gave them back as it was too expensive, but I did continue to have loans from them for some years but there came a time when I was only paying off the minimum and I was put in the bad debt category and they would not give me any more loans”.*

The subsequent cost implications and growth of financial debt caused by just paying a very low minimum repayment amount, that when interest is added does not allow for the debt to eventually be repaid, was referred to by a number of focus group members in different circumstances. A Cumnock participant noted her situation with mail order catalogues: *“Macy club book is okay, but JD Williams is dreadful – your balance never goes down because they add on so many cover charges and they only ask you to pay the minimum balance each time. It’s like a credit card – because you only make the minimum payment, so if you owe £280 and only pay the minimum, then next time you get the statement it’s still £280 plus interest, because you only paid the minimum”.*

**In a sense, buyback stores appear to be unregulated “lenders” as the money advanced on an item is not a loan, but a sale, and a person must “buy back” their item instead of “repaying” a loan.**

In the groups, two other areas of difficulty with terms and conditions arose. There was particular confusion on how weekly repayment shops, such as BrightHouse, calculate their charges which usually are a mixture of insurance and service cover and delivery on top of the high cost of the item sold on credit at a rate of 29.9% APR. All this was not understood in any clear way. The result was that people focused just on the affordability of the level of the weekly repayment. Not everyone realised the fact that, as the minimum repayment is set so low, the loan is spread over a long period, and this causes the cost of the loan to be much higher.

There was also evidence of new entrants to the alternative credit market, such as buyback stores, being understood as similar to pawnbrokers. However, unlike a pawnbroker, the terms and conditions of a buyback store do not allow for the retention of the item through paying interest only. If the item is not redeemed within 28 days it is lost. In a sense, buyback stores appear to be unregulated “lenders” as the money advanced on an item is not a loan, but a sale, and a person must “buy back” their item instead of “repaying” a loan.

People are not always clear about the cost of this form of “credit”. There were numerous stories of people being offered significantly less than the item was worth and also losing high value items as a result of short-term credit needs. As one Ladywood participant noted, *“I went in with a TV and got offered £124 but it was worth hundreds”.* In buyback stores, it is common to receive only one third of the value of an item and, on redemption, to pay a charge that equates to an interest rate in excess of 1,000% APR.

## Understanding the cost of credit

Similarly to previous research (Jones 2001), participants in the groups focused more on the accessibility and availability of a loan rather than on its cost. As one young man in the Wythenshawe group stressed about his use of a buyback store:

*“Do you get the value of the item? You don’t care how much you get for it, so long as you get a loan”.*

A woman in the Cumnock group noted, *“You know that you pay over the odds but if you are desperate you take it”.*

In general, the cost of a loan was assessed in two ways, either by the level of weekly repayments or by the total amount payable on a loan. In the groups, the cost of lending was explained by using real examples of how much people had actually paid on real loans for real items. *“For £100 of vouchers you have to pay back £135”*, noted one Liverpool participant. In calculating cost, APR was not referred to.

**“For £100 of vouchers you have to pay back £135”.**

**In calculating cost, APR was not referred to.**

While focus group members were aware that the concept of APR was related to the cost of a loan, it was not widely used to explain the cost. When asked about the APR of home credit, in Ladywood for example, the range of replies were between 15% and 40%. The fact that it could be more like 180% was accepted with incredulity. The young men in Wythenshawe did not have a benchmark for comparison: *“Is 40% expensive? I don’t know, you tell me”.* Even though APR is seen as significant there was a lack of ability to use it to make real comparisons. A woman in the Barry focus group, however, was an exception. *“I know the credit union charges 12.68% APR – therefore anything higher than this is expensive”.*

**“Is 40% expensive? I don’t know, you tell me”.**

## 4. The challenge of building financial capability

*“Improving people’s ability to make financial decisions is in everybody’s interest. It saves people money, time and a lot of worry. And in years to come they will benefit from the informed decisions that they make now and the freedom it gives them”.*

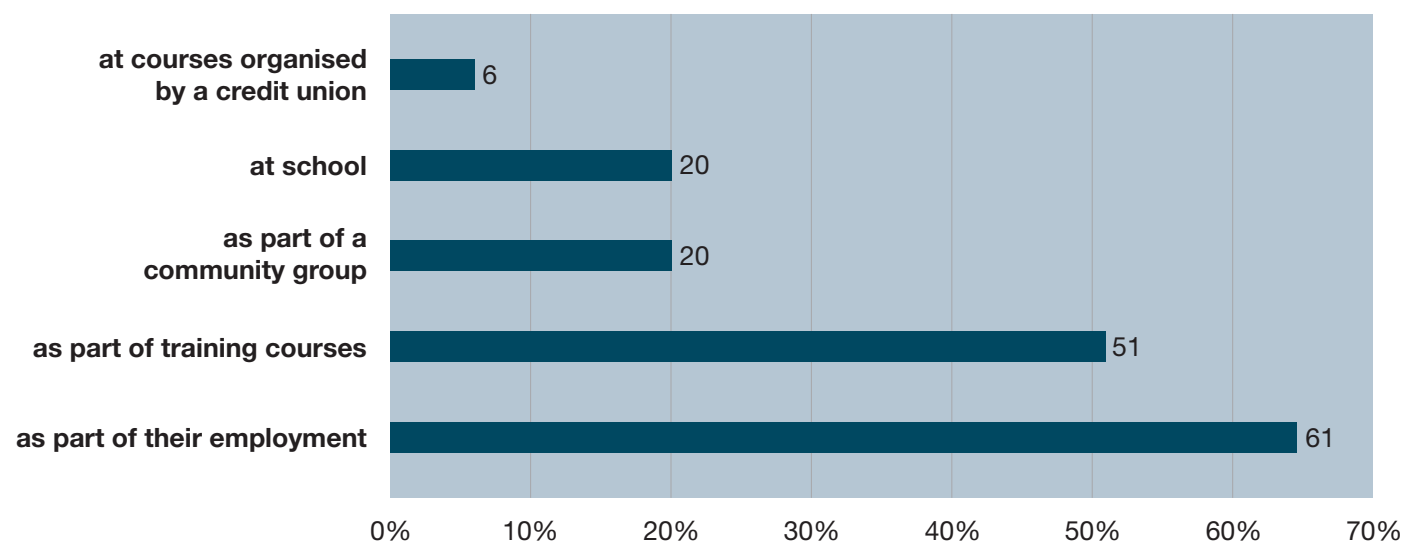
*John Tiner, Chief Executive, Financial Services Authority and Chair of Financial Capability Steering Group (FSA 2004).*

Myths and uncertainties about the terms, conditions and cost of credit that surfaced in the five focus groups undoubtedly led to greater financial exclusion in the lives of people borrowing on a very low income. In common with the Institute of Financial Services (2004), very few people, if anyone, in the focus groups understood the significance of APR and, in a number of cases, credit that was evidently extortionate was considered to be reasonable or affordable. People had difficulty in understanding the complexities of home credit top up loans, the additional charges levied by weekly repayment retail shops and television meter repayment lenders<sup>1</sup> and, in general, loan applications and credit agreements. Particular difficulties with ‘making ends meet’ and budgeting were experienced when returning to work after a period of unemployment.

### Improving financial literacy

It is hard to see how any real improvement can be made in the financial situation of low income people who borrow from alternative lenders without improving financial literacy. To understand the conditions and costs of alternative credit from doorstep lenders, BrightHouse, Telebank, cheque cashing shops, pawnbrokers and others demands a significant financial capability. However, only 5 focus group participants out of the 43 had any contact with financial literacy education or training. On the other hand, 22% of those responding to the national quantified survey had attended financial literacy training courses. 61% had done so as part of their employment, 51% as part of training courses they had undertaken, 20% as part of a community group, 20% when they were at school and 6% at courses organised by a credit union. Overall, those attending financial literacy courses found them to be quite or very useful. 100% of those attending courses in the community found them very useful (79%) or quite useful (21%). 95% of those attending courses as part of their employment found them very or quite useful. The same was true for those who had attended courses at school. 100% found the courses very useful or quite useful. Overall, the majority of respondents attending financial literacy courses were women. The percentage of women

## 22% of survey respondents had attended a financial literacy training course



attending courses in the community was 79%, in employment 80%, on training courses 74% and in school 63%.

It is important to stress that improving financial literacy within very low income communities turns on enabling people to understand the complexities of the alternative credit market. Often literature and course materials cover a wide variety of financial products, all of which may not be appropriate to low income consumers. Financial literacy information, training and support should be targeted towards, and appropriate to, the needs of different income groups within society.

**Financial literacy information, training and support should be targeted towards, and appropriate to, the needs of different income groups within society.**

## Financial literacy in the community

In the focus groups, however, there was a significant amount of scepticism about attending financial literacy courses. Not everyone was willing to participate in a formal course. *“If I won the lottery then perhaps I would have some money to manage. If you have only got £40 what is there to learn about managing that? If I had thousands, it’d be different”*, argued one Cumnock woman. This leaves financial literacy trainers with a particular challenge. Ways have to be found to improve the financial literacy of people using alternative lenders without the expectation that they will be willing to attend formal training. Of course, financial literacy training has to begin in schools. The introduction of financial education in the National Curriculum has been an important step forward but, as yet, there is no real evidence as to its impact. It is often the case too that those young people in danger of using alternative lenders can be alienated from school and find formal education in general to be less than a positive experience.

**Financial literacy training has to be carried out within existing grassroots community organisations and become part of the social networks that impact on people's lives.**

Given the understanding that most people learn about credit through direct personal contact with others, through telling stories and sharing information, financial literacy training has to be carried out within existing grassroots community organisations and become part of the social networks that impact on people's lives. This can be done in a myriad of different ways. Youth workers, housing, social and community workers need to be familiar with the language around alternative credit and to be able to engage in conversations with people that are able to reflect and think about the impact of such lending on their personal finances. As yet, however, financial literacy does not form part of the national curriculum of youth and community work. For the most part, financial literacy training is omitted from university courses offering a professional qualification in youth and community work.

In addition to professional workers, however, voluntary organisations, credit unions and grassroots community groups can do a great deal in telling stories about credit that influence people's thinking. In particular, the credit union movement needs to be more aware of its competition and to be able to explain the disadvantages of alternative lending in simple terms.

**In particular, the credit union movement needs to be more aware of its competition and to be able to explain the disadvantages of alternative lending in simple terms.**

## Be a financial buddy

Huyton Money Advice and Budgeting Scheme (MABS), in Liverpool, has launched a new initiative aimed at recruiting and training 'financial buddies'. A financial buddy is a community volunteer who undergoes a basic information course on financial products required by the financially excluded such as savings, insurance and loans, including alternative lenders. The financial buddy is prepared to share that information through story telling in a range of community locations. In Huyton, the aim is for financial buddies to be members of the community, known locally and accessible to people on the doorstep, in pubs, in the launderette, in churches, in community centres and wherever people meet. The volunteers are not money advisors but people who now have accurate information about financial products. People often gain information about credit amongst their social networks in their local pub. Therefore it is intended that the initiative will operate with a 'financial buddy' in public houses. Within the local pub there will be a person who is known to understand financial services and will be able to share accurate information rather than the myths and unrealities that may be obtained from others.

## Organising financial literacy training effectively

In common with many voluntary organisations, Huyton MABS also organises financial literacy and money

management courses. As has been noted above, in the national survey, those who had attended such courses experienced them as extremely valuable.

However, attracting people on very low incomes, used to borrowing from alternative lenders, to financial literacy training courses is not always easy. The Department for Education and Skills has tried to target hard to reach groups by sponsoring five Community Finance Learning Pilots, the outcomes of which have yet to be disseminated. Norris Green CAB, which operates a financial skills for life programme in North Liverpool, has found that encouraging people to participate in courses depends very much on close personal contact and is often more successful when people are contacted through established groups. Following the theme of this report, courses succeed when people are attracted to them through existing social and community networks. People need to hear stories from others about how worthwhile the courses are.

The teaching style of the course is equally fundamental to success. It has been found by one of the financial literacy trainers in Liverpool that the most effective learning takes place when the trainer stimulates discussion on a subject and encourages the trainees to talk and share their stories on that subject. The tutor can then provide a context and explanation which will help to facilitate understanding and develop learning from the stories told.

In other words, courses need to be fundamentally participative and build on the existing experience and learning of those involved. By recognising the learning that has already taken place, albeit inadequate and even erroneous, the tutor builds the confidence of the participant in a way that enables new understandings to come about. Financial literacy courses need to focus on informal learning in which people are enabled to reflect on their own past experience and develop new strategies for the future. They cannot just be about supplying information in a formal manner.

Encouraging people to participate in courses depends very much on close personal contact.

Financial literacy courses need to focus on informal learning.

**The most effective learning takes place when the trainer stimulates discussion on a subject and encourages the trainees to talk and share their stories on that subject. The tutor can then provide a context and explanation which will help to facilitate understanding and develop learning from the stories told.**

Importantly, participative informal learning aims to build assertiveness and confidence in the participant. In the words of a debt advice worker in Liverpool, *“training should be able to empower consumers to be assertive in negotiating with creditors. Training can make a difference as it gives people the confidence to negotiate”*. Such an approach to training would appeal to one Cumnock focus group participant who stressed, *“You’d probably get more people*

*going on courses like that if it was how to avoid getting ripped off, know your rights – that sort of thing*". In the Ladywood focus group, becoming more assertive was identified as a key issue in the ability to escape from alternative lending. Growth in assertiveness must be a necessary outcome of any financial literacy training course.

## Returning to work

Participants in the Ladywood focus group spoke about how difficult it was to budget and understand finances when returning to work. The need to raise funds to return to work caused some women in the group to become indebted to home credit companies. *"It's difficult to budget and understand all the changes when getting a job"*, explained one of the Ladywood women, *"there was nowhere to go for help and that's when I got into trouble. I borrowed from home credit to get the clothes to go to work"*. It is generally accepted that financial literacy training can be most effective if targeted at key stages in life. Returning to work is a particularly important stage to consider. A person, used to living on benefits, can be very unsure of what is involved when they return to work. Not only is there the problem of financing the return, but there will be expenses and charges that the person will not have been accustomed to budgeting for.

**People returning to work can find themselves immediately in rent and council tax arrears and struggling to manage their income to budget for their 'new' expenses".**

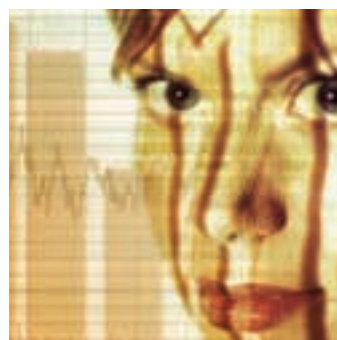
*"Lots of money is spent on getting people back to work, but nothing is done to help people budget and manage their finances when returning to work"*, argued one of the Liverpool debt advice workers, *"this time is crucial because many long-term unemployed have become used to having things paid for them such as their children's school meals and the rent. Then suddenly they are without money until their first pay cheque as income support run on has been stopped. At the same time, they are also suddenly expected to budget and plan for expenses that were previously paid for when they were unemployed. People returning to work can find themselves immediately in rent and council tax arrears and struggling to manage their income to budget for their 'new' expenses"*.

## Advice and support

Even if people have good financial information, as the woman in Ladywood noted above, they still need help and advice to make the right decisions. Financial literacy training is only one part of a comprehensive strategy to combat the increasing financial exclusion caused by borrowing from high interest alternative lenders. It must be complemented by appropriate advice and support. A number of people in the focus groups spoke either of the difficulty in finding advice or, in places where there were money advice agencies, the importance of being able to turn to a money advisor for help. But there is a third part to the jigsaw. Information and advice must often be complemented by personal support. As a CAB worker in Liverpool explained, *"Older people have learnt the hard*

*way, for them, more information on the wrong choices they have made just makes them feel worse. You are just telling them how wrong they are, and making them feel stupid. They already feel trapped and now you are telling them they are being ripped off too*". If advisors are not careful, information and advice, in a situation where people have very little choice, can be counterproductive. It is for this reason that organisations such as Huyton MABS and Ladywood Credit Union include personal support as part of their strategic approach to tackling over indebtedness. Both organisations offer budgeting schemes which assist people to repay creditors by making regular payments through the credit union.

**Information, advice and support must be complemented by access to affordable credit alternatives.**



**“Older people have learnt the hard way, for them, more information on the wrong choices they have made just makes them feel worse. You are just telling them how wrong they are, and making them feel stupid. They already feel trapped and now you are telling them they are being ripped off too.”**

### Identifying affordable alternatives

If financial literacy training, advice and support are three elements of a holistic and strategic response to over indebtedness to alternative lenders, there is also a fourth. In many ways, this is the most important of all. Information, advice and support must be complemented by enabling people to access affordable credit alternatives. For participants in the focus groups, training on financial choices was very difficult to accept if the only choices available were high interest and expensive. It has already been demonstrated that people do need credit at various points in their lives. Financial literacy training ought to be able to direct people towards affordable options.

## 5. Identifying affordable alternatives

### – the role of credit unions in low income communities

Even though the focus groups included participants who were unclear about the cost of alternative credit, the national survey revealed that overall most people are not daft, they know that alternative lending is a “poor or bad deal”. 61% of respondents indicated that home credit was a bad deal, 60% believed pawnbrokers offered a bad deal, 60% believed buyback stores were, 60% and 58% felt the same about weekly repayment stores and cheque cashers, respectively. Catalogues were judged differently with only 33% considering they were a bad deal. Significantly, only 10% believed credit unions to be a bad deal with 66% considering they were a very good deal (47%) or quite a good deal (19%).

Any strategy to combat poverty and over indebtedness occasioned by borrowing from alternative lenders must include the provision of access to more affordable options. Financial literacy training, financial buddy schemes, money advice and support without the availability of alternative affordable options for credit can cause people on low incomes to remain vulnerable and entrapped to alternative lenders. It is well documented that people need credit at different points in their lives and, if high cost alternative lenders are the only lender available, people have little choice but to use them.

*“People know they are being ripped off, but they have no other options. You can give people as much information as possible, but if they have no other choices, it makes no difference”. CAB worker in Liverpool.*

Banks are not best placed to serve low income consumers with the types of loans they often want and require. The use of sophisticated data-driven credit assessments by banks is unsuited to providing a sensitive analysis of the complicated lifestyles of low income consumers. Nor is it cost effective for banks to provide small loans with facilities for receipt of small, weekly cash repayments, as well as personal one-on-one financial advice. Moreover, and perhaps more importantly, people on very low incomes are often unattracted to mainstream banking services (Jones 2001). Banks are often not the kind of financial provider that people on a low income may want to use.



**If high cost alternative lenders are the only lender available, people have little choice but to use them.**



## Credit unions in low income communities

Evidence does point to the fact, however, that people are much more comfortable in using locally based credit unions that are part of the community and are accessible through local social and community networks.

Consistently research has demonstrated that credit unions are best placed within the financial services industry to serve those on low incomes (Conaty and Bendle 2002, Whyley and Brooker 2004, Regan and Paxton 2003). In the Ladywood focus group, several of the women had been able to avoid using alternative lenders because of the existence of Ladywood Credit Union. They had heard about the credit union from family and friends and were able to join because it was accessible to them locally and it was able to offer small loans with the kind of terms and conditions that were attractive to them.

Ladywood Credit Union was established primarily to serve low income members, many of whom were over indebted to alternative and predatory lenders. It has strong links with money advice and debt support agencies and is an active participant in a network of community organisations. Given the importance of social networks in accessing credit (see chapter 3), it is this involvement in the community that enables low income members to join easily.

## Taking a strategic approach

It would be simplistic to consider that access to credit union loans is the solution to over indebtedness to alternative lenders. Previous research has shown that ad hoc responses to debt problems based solely on making loans to pay off alternative lenders have achieved very limited results (Jones 2003). Over indebtedness is a multi-faceted and multi-layered problem and demands a more strategic approach. As already discussed in chapter 4, an appropriate strategic response to over indebtedness, or dependence on alternative lenders, includes financial literacy education, money advice, personal support as well as access to savings and loan accounts and, often, support with budgeting. Ladywood Credit Union has endeavoured to take a more strategic approach and, together with a local money advice agency, offers advice and support as well as budgeting accounts to members.

## Strengthening credit unions

Ladywood, in common with many small credit unions established in low income areas, has limited organisational capacity and, effectively, can only serve a limited number of members having difficulties with over indebtedness or dependence on alternative lenders. It has around 500 members and is organised by a team of 20 volunteers supported, since 1999, by one employed staff member, whose salary is funded with a grant from a government agency. Recently it has expanded its common bond in order to develop its membership and organisational strength.

**A modernised credit union can make an instant loan to a member, irrespective of savings balances.**

A range of programmes has been introduced into the British credit union movement aimed at transforming credit unions into more modern, market-oriented financial institutions so that they can better serve low income communities. This involves restructuring credit unions so that they are able to prioritise financial discipline, economic strength, professionalism and quality in financial services. Importantly for low income members, it involves separating saving from lending, a link traditional in British credit unions, so that members can save but also separately obtain loans based on their capacity to repay.

A modernised credit union can make an instant loan to a member, irrespective of savings balances, so long as it is assured the member can repay. Instant access to credit has always been one of the reasons why people on low incomes have been attracted to alternative lenders. A modernised credit union can effectively respond to this need and offer an immediate affordable alternative to those who would otherwise be attracted to home credit companies or other high interest lenders.

## The equivalent of basic bank accounts

Our national quantified survey identified that 14% of respondents did not have a bank account, of which 46% were in the 26-45 age group. According to the CAB, this is to be expected as younger and older people are often required to open bank accounts as a condition of receiving salaries or state benefits, whilst the middle age group has so far missed out on initiatives to bank the unbanked. 75% of survey respondents had a debit card. People on low incomes also need the equivalent of basic current accounts with standing orders and direct debit facilities if they are to be financially included. A number of credit unions are now arranging for state benefits to be paid directly into credit union accounts. Not only does this take organisational capacity to manage effectively, it demands the member being able to access their cash when they want to. For the most part in today's society, this means being able to access their money via a cash machine. Savings on payments to utility companies, also, depend on being able to arrange direct debits, an advantage missed by those on low incomes without bank accounts. In the focus groups, there were a number of examples of people using cheque cashers because they could not process cheques through a bank. *"I got £628 back on a £800 cheque every month for 6 months from the cheque cashers, it was the only way I knew to cash cheques. In my bank account, I cannot save, they would not let me put money in, I just use it for child benefit"*, reported one of the women in the Ladywood focus group. Credit unions do not have the organisational capacity to implement the equivalent of basic bank accounts and transmission services themselves. For this reason the Association of British Credit Unions Ltd is seeking a banking partner, to enable credit unions to gain the infrastructure and electronic platforms to make basic banking possible through credit union accounts. Without such a facility, it will be very difficult for credit unions to serve large numbers of low income members effectively in the long term.

People on very low incomes are often unattracted to mainstream banking services.



## The positioning of credit unions

Modernised credit unions aim to serve diverse sections of the population. They attract employee groups, people seeking ethical finance and a personal, localised service and, of course, those on low incomes and who suffer financial exclusion. It is within this low income market that restructured and strengthened credit unions can play an increasingly important role. The banks, and other mainstream financial providers, are not able to serve the 7.9 million people still affected by financial exclusion (Datamonitor January 2003).

As mentioned earlier, people on very low incomes are often unattracted to mainstream banking services. Government has tried to respond through the creation of its own lending agent, the Social Fund, which provides loans to people on particular state benefits. However, it has been much criticised as bureaucratic, underfunded and unable to meet the credit needs of the financially excluded in general (CAB 2001).

Credit unions are potentially the most effective vehicle to serve cost effectively the financially excluded and low income communities. However, to serve this market successfully will depend both on a robust partnership with a bank and capital investment by government or the private sector and a successful marketing strategy. It will also depend on credit unions having the legal flexibility to charge market rates on loans that reflect the cost of serving higher risk, low income consumers. Evidence from both the focus groups and the national survey indicates the potential of credit unions to position themselves within the social and community networks through which people on low incomes, including the financially excluded, access credit. But to serve them successfully and effectively in the longer term will demand the continued strengthening and modernisation of credit unions as co-operative financial institutions.

# 6. More than just credit

## – findings of the national survey

A multiple choice survey was distributed by an independent market research company through thirty community based organisations in Liverpool, Manchester, Birmingham, London, Glasgow, Cumnock and Wales. These included money advice agencies, citizen advice bureaux, credit unions and registered social landlords. There was no specific control over who completed

the questionnaire apart from the fact that it was distributed in locations frequented predominantly by low income consumers. Advice on completing the survey indicated that it should only be completed if the respondent had experience of using alternative credit providers. 315 low income consumers completed the questionnaire.

The scope of the survey did not confine itself

solely to access to credit. It posed questions about access to banking services, saving and financial education. However, it also focused on alternative lending and explored respondents' use of pawnbrokers, buyback stores, weekly repayment shops, home credit companies, credit unions, store and credit cards,

mail order catalogues, cheque cashers as well as banks and building societies.

This chapter sets out the main findings of the national survey.

**67%**  
of survey respondents were women and the highest number of responses (44%) came from people in the 26-45 age range. 23% were over 56.

**39%**  
were in full time or part time work, 12% were unemployed, 13% permanently sick or disabled, 9% retired, 9% home workers, 4% self employed, and 8% in education or on training courses.

**46%**  
of survey respondents had an average weekly household income of less than £160 per week and 72% of all respondents received some form of state benefit.

**68%**  
had experienced financial difficulty either now or in the past, 13% of whom stated they were always in financial difficulty. 64% of those experiencing financial difficulty struggled to pay their everyday household bills.

**72%**  
were White British and 15% Black, Black British or Asian.

## Access to banking services

### Bank accounts

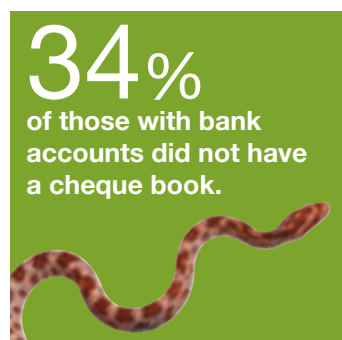
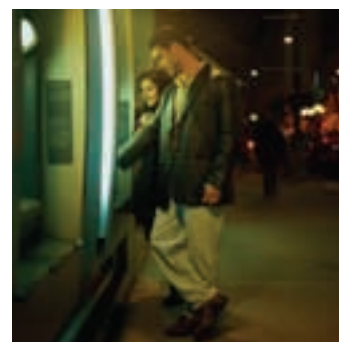
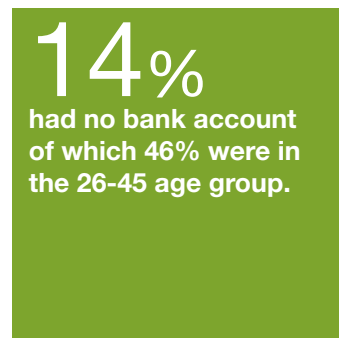
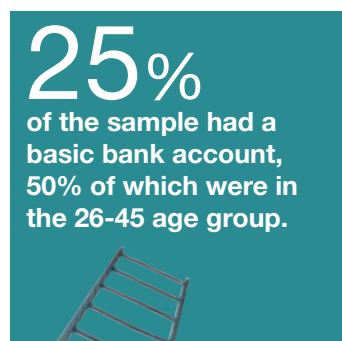
The young and old appear to open bank accounts mostly to receive benefits or when taking up employment. Young people on youth training schemes, for example, must open a bank or post office account. It is people in the middle age

range that are mostly without bank accounts.

Interestingly, without basic bank accounts, 39% of the sample would have been unbanked.

The CAB in Liverpool has recorded examples of people being refused basic bank accounts by some bank branches because they have a poor credit history. The procedure should be that a person applies to open a current account, and if,

following a credit check this is refused, then a basic bank account should be offered. The CAB is equipping its clients with FSA leaflets on basic bank accounts to enable them to insist that they be provided with an account. The right to a basic bank account is soon to be recognised in the revised edition of The Banking Code.



### Debit cards

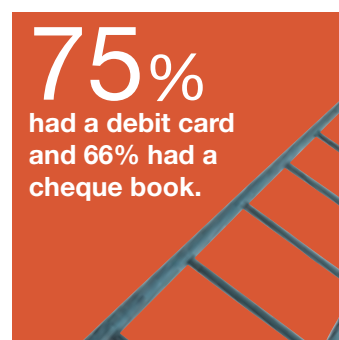
In line with national trends, the use of a plastic card is increasingly more common than using a cheque book.

### Cash machine use

89% of people with bank accounts used cash machines, 77% of whom were under 55. 11% with bank accounts do not use cash machines, this rose to as many as 48% in the 56 plus age range.

Unsurprisingly, older people are the largest group of non-users of cash machines. 71% of respondents in the 66-75 age range found cash machines difficult to use.

Of those not using cash machines, 53% said it was the fear of being mugged and 42% that they could not see the screen.



**82%**

of respondents saved or put money on one side, only 18% indicated that they could not afford to save.



**73%**

of people on a weekly income of £60-100 indicated that they were able to save.



**70%**

of women respondents save, 30% of men saved.



**62%**

indicated that they had used lenders which they would not use again. The reasons given were that the loan was too expensive (62%), too many hidden charges (32%), and that the lender did not understand their situation when a missed payment was made (32%).



### Saving

The results on the savings question are problematic. In general, other research indicates that people on low incomes are able to save very little. In fact, sometimes people are scared to save as they consider it may affect their benefits. There are three possible explanations for this high figure of 82%. First, the inclusion of an option to “put money to one side” was interpreted by respondents as about budgeting to pay bills instead of longer term savings. Secondly, a lot of people do save in a Christmas Club or for a Christmas Hamper to which they allocate a small affordable amount each week. Thirdly, a significant number of returns came from locations with credit unions. Here, low income members do regularly save, albeit small amounts. Whichever explanation is preferred, the return does challenge the view that people on very low incomes cannot save at all. Given the appropriate facilities, as the survey shows, saving is not only possible, but valued.

An important point that the returns demonstrate is that there are far more women savers than men. This highlights perhaps the role women play in household budgeting and their ability to make ends meet.

**42%**

were saving weekly or monthly. 18% saved weekly and 24% saved monthly.



### Borrowing

The survey does indicate that the majority (60%) of those who replied knew that their lender was expensive or had hidden charges.

### Pawnbrokers and buyback stores

8% of respondents used pawnbrokers, 73% of whom were women and 27% men.

The survey indicates that there is a clear female preference for pawnbrokers, as, for the most part, pawns are in the form of jewellery.

**54%**

of survey respondents currently have an outstanding loan, 38% were repaying two to five loans.



29% of people using pawn shops failed to recover the item pawned because they “forgot about it”.

5% of respondents used buyback stores. 53% were male, 41% of whom were under 25.

As was confirmed in the Wythenshawe focus group, young men prefer to use buyback stores.

35% of people using buyback stores failed to recover, and therefore lost, the item, 64% of whom could not afford to buy it back.

This is a clear indication that around a third of people using buyback stores are losing a valuable asset. Sellers only receive a fraction of the value of an item which, if not redeemed or bought back, means a significant reduction in their personal assets.

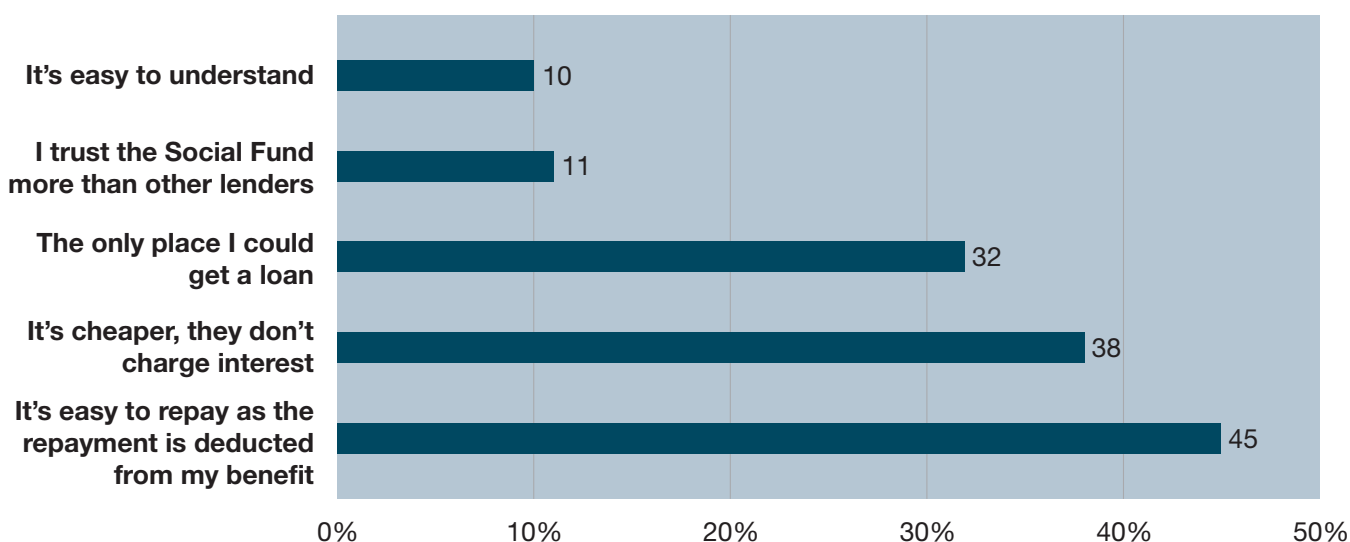
### Shops that cash cheques

11% of respondents used cheque cashing shops. 53% used them to cash cheques they had received from someone else and were not able to clear through a bank account. The average fee charged for this service is around 10% of the cheque’s value. 27% used them as a loan on their own personal cheques. They repaid the “loan” to the shop before it deposited the cheques in the bank. The cheques, in these cases, were used as a guarantee against the debt. 23% used the cheque cashing shop to raise cash in advance on a personal cheque which was later banked by the shop. Charges can equate to as much as 396% APR (see Appendix I).

### Social Fund

30% of respondents had used the Social Fund.

### Reasons given for using the Social Fund



Note: The percentages are those of respondents replying to the question.

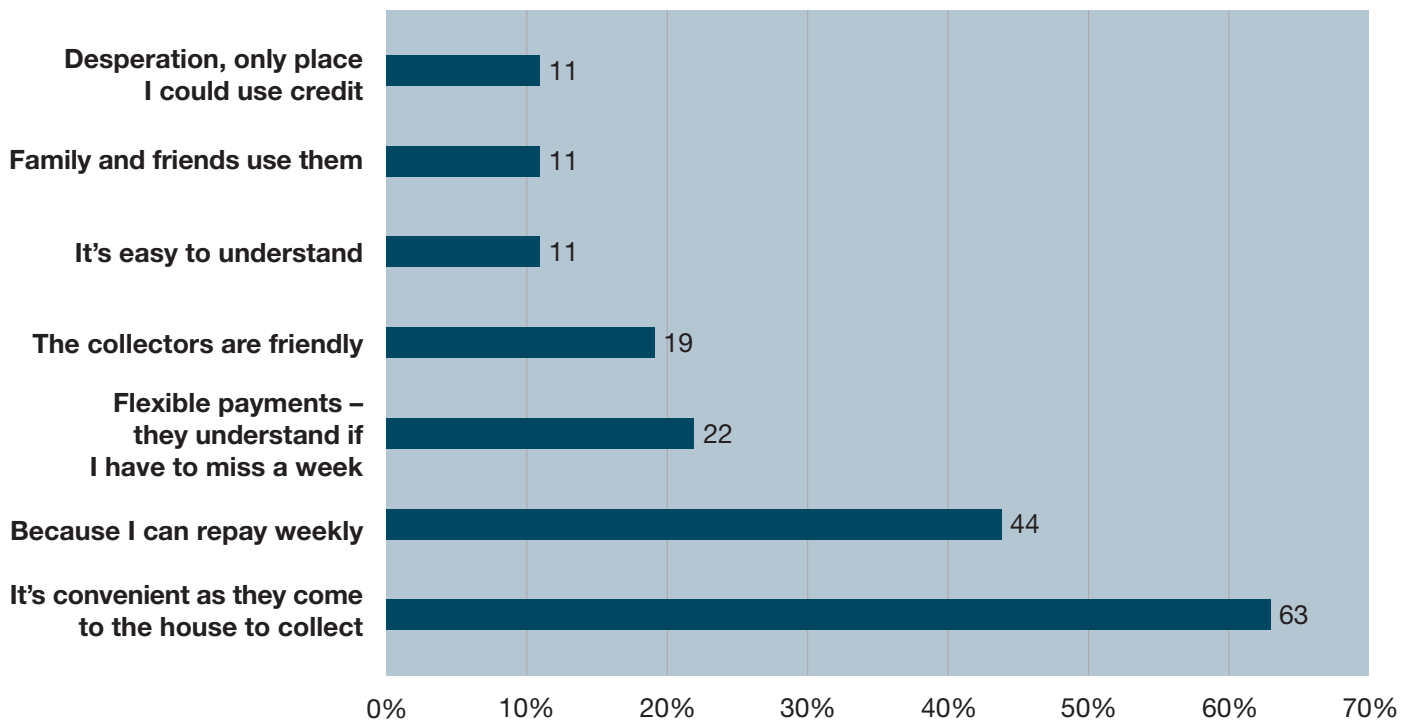
## Would you credit it?

Of those not using the Social Fund, 56% were not eligible to use it, the majority of whom were still on low incomes of less than £300 per week.

### Home credit

9% of respondents used home credit. Those not using home credit gave the fact that it is too expensive as the main reason for not using it (58%).

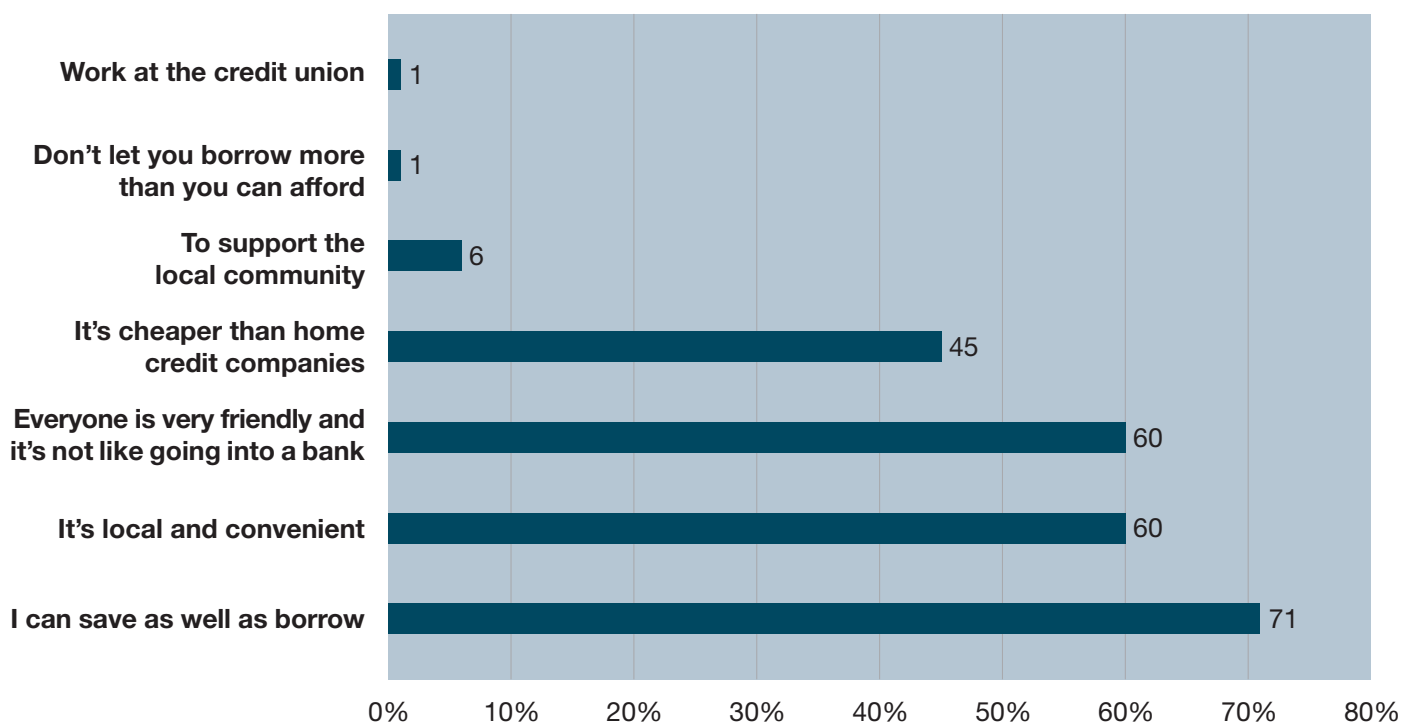
### Reasons given for using home credit



### Credit unions

47% of respondents used a credit union, and it is acknowledged that this is disproportionately high. In several of the locations through which the survey was distributed, there was a credit union. This is undoubtedly a factor impacting on some of the responses – the high incidence of saving and the low incidence of using home credit. This needs to be taken into account when reading the survey results.

## Reasons given for using credit unions



Clearly people use credit unions primarily because they can save as well as borrow. This challenges the view that people on low incomes cannot and do not want to save. Having a safe place to save is very important in a low income community. Significantly, people use credit unions as they offer them a local, convenient and friendly service. They do not use credit unions for ideological or philosophical reasons. Only 6% are interested in supporting the local community as a main form of motivation.

### Weekly repayment retail shops

11% of respondents had bought goods from a weekly repayment retail shop (such as BrightHouse), 76% of whom were women.

Goods purchased from a retail shop are on hire purchase. However the implications of this were not understood well by respondents. Only 44% recognised that hire purchase meant that the shop could repossess the goods. 38% thought (incorrectly) the difference between hire purchase and buying goods on credit was that the purchaser had to have insurance. 34% admitted that they did not know at all. 9% considered (incorrectly) that hire purchase meant that the shop could not repossess the goods.

### Mail order catalogues

40% of respondents used mail order catalogues, 79% of whom were women. 67% of users were their own catalogue agent. 33% used the agency of others because they found it convenient to do so.

## Would you credit it?

35% considered that a mail order company could take a defaulter to court. [In fact, this is difficult to do as there is no credit agreement.]

### Cost of borrowing and credit checks

24% admitted to not knowing the APR on the loan they were repaying.

For one in four of the respondents, APR is either not of prime concern or not understood.

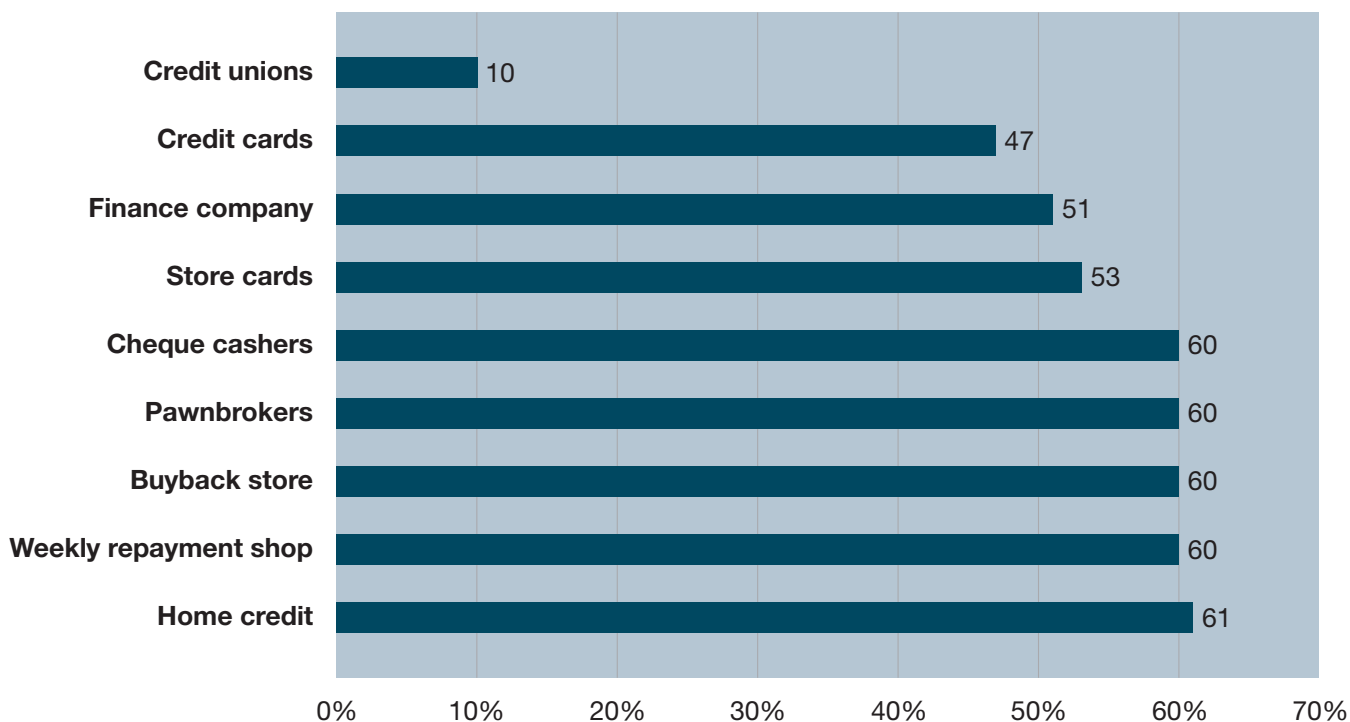
47% of respondents knew APR refers to the cost of loan but 27% calculated the cost from the amount repaid each week.

68% of respondents said having a credit check would make no difference to their applying for a loan, 20% felt it meant it would be unlikely that they would get the loan, whilst 18% said that they would be put off applying if they had to have a credit check.

### Attitude to credit providers – value for money

People were asked to assess the value for money of a range of alternative lenders. They were asked in terms of whether or not a particular lender was a good or a bad deal. For the most part, the majority of people knew alternative lenders were a bad deal albeit they may use them regularly or from time to time.

### Those considering a particular form of credit as a bad or very bad deal

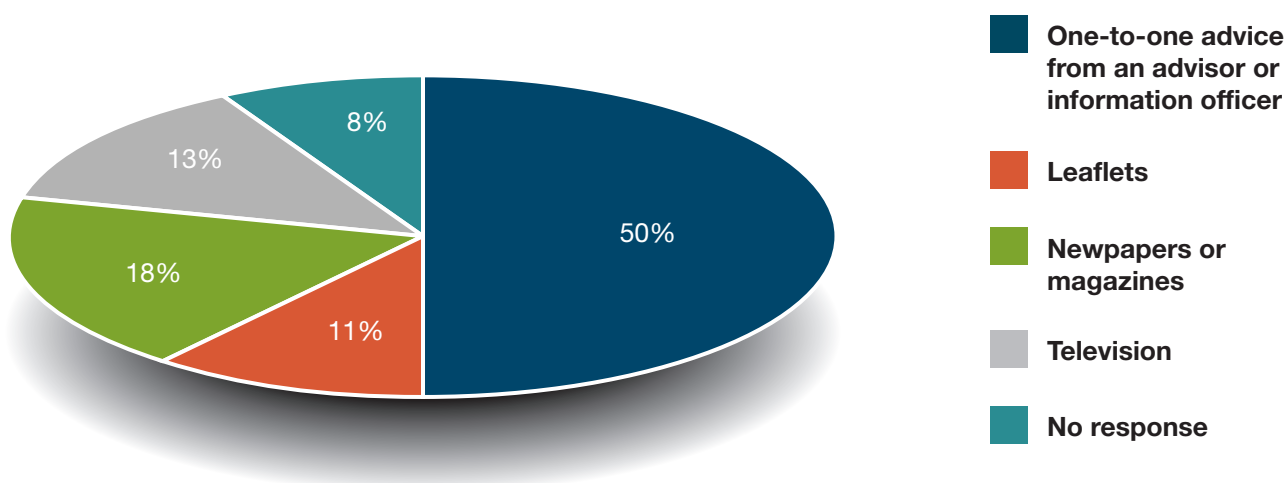


### Experience of financial difficulty and seeking advice

68% of survey respondents were in, or had experienced, financial difficulty, 64% had difficulty with household bills, 40% with loans and 31% with credit cards.

43% had sought advice from the CAB, 22% from a bank, 17% from a credit union and 10% from a money advice agency. 14% said that they would not seek personal advice. The organisation found most helpful by the largest number (31%) was the CAB. This was followed by the credit union (13%), the bank (10%) and a money advice agency (5%).

### Seeking advice



50% preferred one-to-one advice from an advisor or information officer. Direct personal contact was the most important way of obtaining advice and information. Only 11% preferred leaflets, 18% newspapers or magazines, 13% the television.

### Financial literacy courses

22% had attended financial literacy training, the majority as part of their employment (61%) or training (51%). 20% had done so as part of a community group, 20% when at school and 6% at courses organised by a credit union. Significantly, 73% of those attending financial literacy courses found them useful. 79% of those attending a course as part of a community group found them useful, 79% as part of employment, 77% as part of training, 73% when at school and 67% when organised by a credit union.

## 7. Conclusions

The research through focus groups and a national survey has identified a number of important areas of concern in understanding how people on low incomes access and use alternative credit. In common with the 2001 research, *Access to Credit on a Low Income*, it found that many people on low incomes have little choice when it comes to

**Unless they have access to a credit union, people have no real option but to pay excessively high interest charges.**



accessing credit. For the most part, they are excluded from, or do not use, mainstream financial services and have no option but to use one or several of the alternative lenders available. Of course, as was revealed in the 2001 research, people make rational choices about which form of credit to use. Given their limited options, however, those choices rarely involve the cost of credit. Unless they have access to a credit union, people have no real option but to pay excessively high interest charges.

### The significance of story telling and social networks

Education and knowledge about alternative lending is first gained through the social networks of family and friends within the community. In the focus groups people shared stories of the forms of credit they used and it was from these stories, told and retold in the community, that people gained information about alternative lending.

**Information was not gained from leaflets or publicity material but through word of mouth in the locality.**

It was reported in the Liverpool group, for example, that people only knew about the local credit union through family and friends who were already members. Information was not gained from leaflets or publicity material but through word of mouth in the locality.

As has been demonstrated earlier, the problem with this form of communication is that it is susceptible to myths, misinformation and unrealities. If a person looks to conversations in the local pub to gain information about credit, the likelihood is that it will be inaccurate and even false. However, in order to communicate more accurate information about lending, it is essential that the importance of local community and social networks are taken into account. Many of the women in the Ladywood focus group only joined the local credit union because it is embedded in a network of community inter-relationships.

## Market failure

Meadows, Ormerod and Cook (2004) argued in their research that because people obtained their information from family and friends, and through social networks, it was this that prevented people accessing mainstream services. As information through social networks was often inadequate and incomplete, financial exclusion was the result of information failure rather than market failure. The findings of this research project and its predecessor (Jones 2001), recognise the reality of information failure but see this as a result of evident market failure. Many people on low incomes have few or very limited choices when needing to access credit. People in the focus groups spoke of how they had no option but to use home credit when they were in desperate need of a loan. There is very little to choose between the terms, conditions and costs of the four main companies offering home credit, the largest of which controls 49% of the market. The National Consumer Council's recent Supercomplaint on the home credit industry recognises that competition among home credit companies hardly exists. Low income consumers in need of credit generally have no option but to pay high and even extortionate credit charges.

Many people on low incomes have few or very limited choices when needing to access credit.

## Understanding the cost of credit

In the focus groups it was clear that people do not understand APR (Annual Percentage Rate). Indeed, people know that APR relates somehow to the cost of the loan, however, its actual significance, relevance and purpose is neither recognised nor understood. Even among the limited credit options available to people, where a lender's APR may vary from 29% to an APR in the thousands, there was little or no evidence of cost comparisons being made using an APR.

Instead the cost of credit was assessed in relation to the manageability of the repayments within a, usually, weekly budget. Indeed, the term APR was very rarely used to describe the cost of a loan, with many focus group participants preferring to express the actual cost in more simple terms using a real example, e.g. *"I paid £30 on a £100 loan"*.

**There was little or no evidence of cost comparisons being made using an APR.**

The research study found that focus group participants experienced a real problem in comparing the cost of credit, not necessarily because of their lack of use of an APR, but as a result of the lack of an agreed benchmark as to what may be considered affordable or expensive. Amongst the focus groups opinion varied wildly as to whether paying £30 on a £100 loan would be considered to be expensive or not.

To an extent, the benchmark of acceptable cost was set within a social network which shared stories of experiences of obtaining credit. However, myths and misunderstandings can distort the value of the informal

learning that can be gained through such a social network. The failure of social networks in providing accurate financial information accentuates the importance of the provision of financial literacy training.

## The human touch

People preferred to obtain information about credit through word of mouth or by direct personal contact with a money advisor, lender or anyone who was able to supply appropriate information. In the focus groups, it was clear that people did not read leaflets or gain information from printed material.

What mattered most was the human touch. In the survey, 50% of respondents preferred to gain advice or information through one-to-one personal contact with an advisor or information officer. Only 11% preferred leaflets, 18% gained information from newspapers or magazines and 13% from the television. Those in the focus groups who were members of credit unions indicated the importance of close personal contact with the staff and volunteers. What appealed was the fact that credit unions are about people helping people.



**What mattered most was the human touch. In the survey, 50% of respondents preferred to gain advice or information through one-to-one personal contact.**

## New entrants into the market

Over recent years, the local high street in many low income communities has seen a rapid expansion in the number and visibility of a range of alternative lenders, many of which are new entrants to the market. In the main shopping area of Wythenshawe, where one of the focus groups was held, there is a Cash Generator, BrightHouse, a large pawnbrokers and, on a day in August, a canvasser promoting Telebank from a temporary stall in the market. In addition, four or more home credit companies operate in the area including Provident Financial, Shopachek, Mowbray's and Schofields. People in this very low income community have limited mainstream financial choices

**The cost of credit remains consistently expensive and consumers remain dependent on high cost lenders.**

but are very well served by the alternative credit market. However, this is not evidence for the success of market forces. The cost of credit remains consistently expensive and consumers remain dependent on high cost lenders. A number of the new entrants are providing short-term loans that are not regarded as credit agreements and therefore are not subject to consumer credit legislation. Cash Generators and Cash Converters, for example, operate a buyback service in which short-term credit is in effect replaced by handing over

(“selling”) ownership of a personal item. Commonly a “loan” of one third of the value of an item can be raised. The customer retains the right to buy back their item at a higher price within a 28 day period. The raising of short-term credit for a 28 day period is replaced by the selling and buying back of a personal item.

Similarly, cheque cashing shops provide cash advances of up to £500 instantly. Receipt of the cash requires a consumer to write out cheques payable to the company for the amount of the advance. The cheques will not be presented to the bank for 30 days.

## Financial literacy in the community

Improvements in the financial situation of those low income consumers that are using alternative lenders largely depends on improving financial literacy. Partly because people are uncomfortable in completing loan application forms, they are attracted by home credit or buyback stores where application forms do not exist. When they do sign credit agreements, there was evidence in the focus groups that they do not fully understand the terms of the contract they are signing. People had difficulty in understanding the complexities of hire purchase, APR and the terms and conditions of lenders such as Telebank and BrightHouse. The ability to budget is another common problem people face, often with significant and disadvantageous consequences.

Financial literacy courses need to be community oriented and to adopt a learning style based on informal and experiential learning. Building upon the knowledge and experience of course participants enables tutors to facilitate not just a growth in knowledge but in confidence and assertiveness which the focus groups identified as a prerequisite of negotiating and dealing with creditors. However, in addition, as was revealed by some people’s negative reaction to course participation, financial literacy initiatives have to reach out beyond courses and into the community itself. Financial buddy schemes are new, innovative and as yet, untested, examples of this happening in practice. But professional workers, such as youth and community workers, social workers, housing workers, home helps and community nurses also need to have some basic financial understanding and the ability to communicate this to people experiencing over indebtedness or entrapment to alternative lenders, particularly those who are hard to reach through other more formal channels.

## Financial literacy in the workplace

The focus groups highlighted the need for financial information particularly at a time of transition into work.

People spoke about how difficult it was to budget and understand finances when moving from a time of dependency on benefits to independence in work. Not only were there new costs involved in starting work but, after living on benefit for so long, there were new costs and charges that often people did not expect. It was at



this time of returning to work that a number of focus group participants took out home credit loans to cover return to work costs.

It is important that financial literacy training regularly forms part of workplace learning. In fact, in the national survey, 61% of those who had attended financial literacy courses did so as part of their employment.

## A strategic approach to building financial capability

As was argued in chapter three, financial literacy training alone does not fully respond to the needs of the over indebted and those dependent on alternative lending. A more holistic and strategic approach is required which integrates financial literacy training, money advice, personal support (including budgeting schemes) as well as more affordable credit options.



### Affordable alternatives

The research found providing financial literacy training, even with money advice and personal support, achieved very limited objectives without affordable options being available. Many people know they are receiving a poor deal from alternative lenders. Training that simply highlights a bad deal without being able to offer an alternative can be counterproductive. It may make people realise how much they are being “ripped off” but it will do nothing for their self-esteem if, by force of circumstances, they still remain trapped and vulnerable to high interest lenders. The research identified the important role of credit unions in providing more affordable options.

## Modernising credit unions

The majority of British credit unions are located in low income neighbourhoods. They were established with a strong social purpose and, for the most part, are committed to serving the financially excluded and low income communities. As was seen with Ladywood Credit Union (chapter 5), they are often embedded in the local community and are active participants in a range of community initiatives and programmes. It is because of their close inter-relationship with local social networks that people hear about them and feel comfortable in becoming a member. Many of the people in Ladywood who join the credit union would never join a bank or building society. Word of mouth communication does not, however, undermine the importance of effective marketing strategies. Word of mouth communication, by itself, can often be too slow and, perhaps, too hit and miss. In low income areas, quality marketing strategies need to complement, extend and strengthen the personal communication that takes place through local social networks.

**Credit unions could even enter the home credit market and offer this form of accessible service but at a cost that people could afford.**

The challenge for credit unions is to be able to provide an immediate and cost effective response to many more low income consumers. This requires the adoption of credit assessment techniques responsive to the needs of low income consumers. For many credit unions this will require removing the traditional requirement to save prior to becoming eligible for a loan. It will also demand a review of service delivery channels so that access to credit is always convenient, easy and straightforward as well as regularly accessible. Credit unions could even enter the home credit market and offer this form of accessible service but at a cost that people could afford.

Llanelli Credit Union, in South Wales, piloted a door-step collection service that proved to be both effective and popular with a certain section of the membership (Jones 2003).

Modernised credit unions can make a significant contribution to tackling financial exclusion. However, they cannot alone be the solution to financial exclusion. For many people, in the most disadvantaged of situations, financial exclusion is just one element of a wider experience of social exclusion. Poor education, bad health, inadequate housing, lack of access to appropriate services, disaffection and long-term unemployment all contribute to a multi-layered reality of exclusion. Given a person's particular circumstances, credit unions may not always be able to assist with affordable credit. In fact, on occasion, making a loan is not the most appropriate response to someone who is over indebted or who lacks the capacity to repay (Jones 2003). Nevertheless, modernised credit unions can provide access to savings accounts and, in many cases, access to money advice and information services. It is worth noting that, as credit unions endeavour increasingly to serve the financially excluded, the implementation of new and innovative services will demand legislative reform to permit the flexibility of charging a market rate that recognises the level of risk involved in serving people in desperate financial circumstances in low income communities.

## 8. Recommendations

The recommendations arising from the research are aimed at:

1. Advising Government, the DTI and policy makers concerned with the credit industry on how to protect vulnerable consumers from high cost lenders.
2. Assisting financial providers that target low income consumers to provide appropriate information that builds financial capability.
3. Encouraging financial literacy trainers to develop financial capability education within and through local social networks.
4. Supporting credit unions to develop a more effective approach to lending to low income consumers.

### **1. Recommendations to Government to protect vulnerable consumers:**

- a. Amendments to consumer credit legislation should recognise new entrants to the alternative credit market. Such lenders currently escape the existing regulatory framework as the selling of goods and the encashment of cheques are not regarded as regulated credit agreements, despite both being utilised as methods to obtain short-term credit.
- b. Recognise that combating extortionate credit can be achieved by means other than placing a ceiling on the annual percentage rate. It involves tackling the various methods and techniques used to increase the overall charge to consumers whilst, at the same time, keeping the APR within reasonable limits. These methods and techniques need to be included in consumer credit legislation.

The various mechanisms used to hide the real cost of extortionate credit can include:

- i. The basic price of goods being set at a much higher level than the usual market price, whether this be from a person selling goods at the doorstep or a high street retail shop. The APR is then charged on the inflated price.
  - ii. A minimum payment being set too low to repay the cost of the interest added, thereby causing the original debt to continue to grow and not be repaid within a reasonable period.
- c. Work with money advice specialists to develop a strategic approach to serving low income consumers which provides financial literacy training, money advice, assistance with budgeting, one-to-one support on financial decision making as well as access to affordable credit alternatives.

## 2. Recommendations for financial services providers targeting low income consumers:

- a. Respond to individual basic literacy needs by providing one-on-one support to aid understanding and completion of forms, as required.
- b. Develop promotional materials and financial information that is sensitive to average literacy levels, within the confines of the formal language required for legal purposes.
- c. Recognise that APR is not widely understood and, in addition to APR, also explain the total cost of credit in a simple easily understood manner e.g: “for every £100 borrowed you repay £X”.

## 3. Recommendations for organisations that employ financial capability trainers working in low income communities:

- a. Financial literacy training needs to encourage and enable people to access information in a way that is appropriate to their needs, learning styles, cultural and ethnic backgrounds and personal experience. Trainers can assist people to develop and share new stories that establish a benchmark for high cost credit. They can provide guidance, support and signposting to enable people to access more affordable lenders.
- b. Financial literacy training should be targeted at key life stage cycles with priority given to explaining choices to young people beginning their financial life and providing budgeting support for people returning to work. One group with particular financial literacy needs are those returning to the community after a period of imprisonment.
- c. Financial literacy training needs to be aimed at providing consumers with confidence to negotiate assertively with creditors and to deal practically with their debt problems.
- d. Formal financial literacy training should be included as an element within existing training provision such as an apprenticeship, employees’ induction training or a student’s training or course of study.
- e. For people not within a study, training or work environment, financial literacy training should be developed as informal learning experiences amongst existing community groups. In order to reach out into the community, a wide range of innovative initiatives, such as financial buddy schemes, should be encouraged and developed. Financial buddy schemes enable local volunteers, trained in basic financial information, to communicate correct information about credit in and through local social and community networks.
- f. There is a need to develop the number of capable financial literacy workers able to work within the fluid and flexible context of community groups and to develop training appropriate to people’s needs.
- g. Despite the importance of financial literacy training within the community, access to appropriate courses is very limited. Government needs to increase funding and support for appropriate financial literacy training in the community.
- h. Financial literacy training needs to form part of the National Youth Agency’s national curriculum for youth work. Equally, it needs to form part of the training of social workers, housing workers and others working directly in the community.

#### **4. Recommendations to enable credit unions to serve more effectively the needs of low income**

##### **consumers:**

- a. The credit union movement needs to be more aware of its competition and to be able to explain the disadvantages of alternative lending in simple terms.
- b. Credit unions need to develop the capability to provide an immediate response to the credit needs of low income consumers through utilising appropriate credit assessment techniques, rather than requiring an extended period of savings to establish credit worthiness. This can be simply achieved through a change in practice within individual credit unions; neither legislative nor regulatory change is required to achieve this.
- c. Credit unions need to support a change in the law to permit the flexibility to charge an annual percentage rate on loans that recognises the inherent costs of lending to high risk consumers.
- d. Credit unions should pilot and launch a doorstep alternative to the current home credit providers. As well as providing a credit service valued by many on low incomes, the use of well informed doorstep collectors would enable informal conversations that lead to effective learning about the terms, conditions and cost of credit in general.
- e. The credit union movement as a whole needs to form a partnership with a bank or banks to develop a strategy that will enable credit union members to access the equivalent of a current account including the use of cash machines.

## Appendix I – Alternative Lenders

The following list outlines the main alternative lenders usually used by people on low incomes. The APR rates or other charges of alternative credit are itemised below:

### Buyback Stores

Cash Generators and Cash Converters are two of the better known franchises operating a buyback service.

Cash Converters was founded in Australia in 1984 and is the largest company with a network of 90 franchised stores in mainly low income communities.

Both franchises offer new goods, pawnbroking and cheque cashing services, as well as a buyback facility.

Short-term credit is in effect replaced by handing over (“selling”) ownership of a personal item. Commonly a loan of one third of the value of an item can be raised. The customer retains the right to buy back their item at a higher price within a 28 day period. The raising of short-term credit for a 28 day period is replaced with the selling and buying back of a personal item. As it is not legally considered to be a credit agreement, it is not subject to consumer credit legislation.

In 2000, a Citizens Advice report, entitled Daylight Robbery, highlighted a CAB in West Sussex that gave an example of a client who borrowed £150 by providing his stereo – valued at £500 – as security to a buyback store. The amount had to be repaid within 28 days with an interest charge of £42. This equates to an APR of 1,834%.

### Cheque cashers

The Loan Store, The Money Shop, BrightHouse and Cash Generator all provide a cheque cashing service. Short-term credit can be provided by cheque cashers in the form of a “payday advance”.

The Money Shop provides a 30 day cash advance of up to £500 instantly. Receipt of the cash requires a consumer to write out cheques payable to The Money Shop for the amount of the advance. The cheques will not be presented to the bank for 30 days. Their promotional leaflet states that a “small commission fee” will be charged for this service. Cash Generator will provide a payday advance of up to £400 on personal cheques that will not be banked for 28 days.

The British Cheque Cashing Association (BCCA) claims that the average fee charged by one of their members for cashing a cheque is around 10% of the cheque’s value. According to Henry Palmer in *“Profiting from Poverty: Why Debt is Big Business in Britain”* (NEF 2003), *“A typical charge for a £40 cheque held for between one and seven days is around £4. To hold a cheque for the same amount for one month would cost around £5, which would amount to an APR of 396 per cent”*.

## Credit Unions

A credit union is a financial co-operative owned and controlled by its members and regulated by the Financial Services Authority. A credit union can accept savings deposits, grant loans, receive state benefit payments and provide bill payment financial budgeting schemes.

The maximum cost of a credit union loan is capped by law within section 11(5) of the Credit Unions Act 1979 at no more than 1% per month on the declining balance. This is equivalent to an APR of 12.7% APR or £6 paid on a £100 loan.

Since 1999 a significant restructuring and strengthening of the credit union movement has occurred and there are now strong credit unions serving the whole of Leeds, Liverpool, West Scotland, Birmingham, Telford, Portsmouth, Rochdale and many London boroughs.

Further information on credit unions is available from the Association of British Credit Unions Limited ([www.abcul.coop](http://www.abcul.coop)).

## Home Credit Companies

Provident and Greenwoods are two of the best known home credit companies with the largest home credit company accounting for 49% of the home credit market. The home credit market has been valued at £2bn with 10% of British consumers having used home credit at some point in their lives. (National Consumer Council Supercomplaint to the OFT on home credit, 2004).

Home credit companies typically provide small, short-term, unsecured loans. The website of Provident Personal Credit provides an illustrative cost of a loan of £500 repaid at £25 a week over 31 weeks. The total amount repaid is £775, at an APR of 365.1%. The loan repayments are collected from people in their own homes.

The home credit companies have defended the high cost of their business in relation to the high cost of their convenient doorstep collection methods by a network of local agents and the extent of credit risk, as explained to the Office of Fair Trading:

*“Home credit lenders told us that the price differential for home credit may be accounted for by factors such as the default risk, the nature of the product (unsecured, short-term with flexible payment), agent network costs and the lenders cost of capital”.* (OFT response to National Consumer Council Supercomplaint, 2004)

## Pawnbrokers

After a period of decline, pawnbrokers are making a return to the local high street. People pledge an item, usually jewellery, for a set period of 6 months, against a cash loan. The amount of the loan is decided on the condition and the value of the article and on the amount requested by the customer. It is usual for a loan of only one third or half the value of the item to be granted. Typically an interest rate of £5 per month is quoted, equivalent to an APR of 69% over six months. The pledge can be extended for further periods by paying the interest due on the loan.

## Telebank

The Telebank catalogue offers household furniture, televisions and other home accessories. Telebank provides an option to pay for a purchased item through a meter attached to the TV. An administration fee of £20 is charged on all new accounts (usually in 4 instalments of £5). Payment by meter TV involves an “additional meter charge of £3.50” per month. All retail products are repayable over 36 months. The catalogue provides a “typical credit example” for a Montana two door wardrobe at a cash price of £200. 36 monthly payments of £8.94 means that the total amount payable is £321.84. However, if making repayments through a meter it is necessary to include 36 monthly repayments for the £3.50 per month meter charge, amounting to an extra £126 for the meter. The total cost for the £200 wardrobe, if paid for by a metered TV, is £447.84, however the APR is quoted as “APR 39.9% variable”.

## Unauthorised lenders

Unauthorised lenders operate in an unregulated and informal environment. Knowledge of unauthorised lenders is most commonly passed on through social networks as the nature of their operations means that they do not advertise or promote their services. Unauthorised lenders can charge however much they choose for a loan as they are not regulated nor subject to any legal requirements. The higher interest lenders can also be known as loan sharks, and are reputed to use threatening and intimidating methods to recover unpaid loans. This survey report found strong evidence of unauthorised money lenders operating in a rural area of West Scotland which did not have any other local alternative lenders.

## Weekly repayment shops

BrightHouse, previously known as Crazy Georges, is an example of a high street weekly repayment shop. It sells retail goods such as televisions and lounge furniture on hire purchase, the cost of which can be repaid weekly in seemingly affordable sums. To qualify for credit, it is necessary to provide the names, addresses and home phone numbers of five friends or relatives, as well as provide proof of residency, proof of income, and two other forms of ID such as utility bills.

Its website presentation is as a company with a strong social mission providing “no strings credit”. The annual percentage rate charged on goods is advertised as 29.9% APR. The real cost of purchasing items from BrightHouse usually includes insurance cover and other charges. In addition, Jenny Rossiter from Church Action on Poverty reported on examples of items being sold at much higher rates than available in another high street shop such as Argos. For example: A New World gas cooker purchased over three years with service cover costs £934, compared to £330 at Argos. A JVC Hi Fi at Argos costs £279.99, whereas at BrightHouse it costs £386.86: £106 more expensive, even if paying cash.

BrightHouse's own promotional leaflet called "Buying made easy" provides a typical example of a washing machine at a cash price of £351.10. In making 156 weekly repayments of £3.24, a total amount of £505.44 is paid for the washing machine. Optional service cover is available at £1.75 per week, which means that the total cost of the washing machine, including service cover is £778.44. The cost of buying this washing machine on credit is £427.34 more expensive than the original cash price of £351.10: more than double the original cost.

## Appendix II – Research Methodology

### Focus Groups

43 people actively participated in a series of five focus groups. All participants were on a low income and had personal experience of using alternative lenders. The focus groups took place in the following five locations:

- Wythenshawe Options, Greater Manchester: 3 women and 9 men
- Cumnock Lunch Club, Cumnock, West Scotland: 11 women
- Anfield CAB, Liverpool: 4 women and 1 man
- Ladywood Community Centre, Birmingham: 8 women
- Valesavers Credit Union, Barry, South Wales: 4 women and 3 men

The focus groups aimed to actively engage the interest and involvement of participants. Each group followed the same format and explored three areas in depth. These were participants' experience of using alternative lenders, an exploration of their understanding of the terms and conditions of alternative credit and of their understanding of the cost of credit. All group proceedings were recorded but each person received a personal assurance of confidentiality. It was agreed that no participant would be quoted by name.

### National Survey

A multiple choice survey was distributed by an independent market research company through money advice agencies, citizen advice bureaux, credit unions and registered social landlords throughout England, Scotland and Wales. 1,145 surveys were distributed and 315 responses were received from low income consumers. Based on this sample, the maximum confidence level is  $\pm 5.52\%$  at the 95% level.

Distribution of the survey through 30 community based agencies was designed to reach people on low incomes: 46% of respondents had an average weekly household income of less than £160 per week and 62% of all respondents received some form of state benefit. 67% of survey respondents were women and the highest amount of responses (44%) came from people in the 26-45 age range. 68% had experienced financial difficulty, either now or in the past, 13% of whom stated they were always in financial difficulty. 64% of those experiencing financial difficulty struggled to pay their everyday household bills.

The scope of the survey went beyond obtaining credit. In addition, it explored questions around access to banking services, saving and financial capability. In regard to credit, it particularly explored the use of pawnbrokers, buyback stores, weekly repayment shops, home credit companies, credit unions, store and credit cards, mail order catalogues, cheque cashers as well as banks and building societies.

### **Professional Money Advisor Focus Group**

A focus group was held in Liverpool with invited CAB debt advice and financial literacy workers to discuss the range and findings of the research. The aim was to check out the validity of some of the initial findings.

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Enhancing financial literacy and improving financial capability have become key government initiatives to help people better understand and manage their finances and thereby become less vulnerable consumers. Underpinning these initiatives is the belief that education and the provision of information can change and improve a person's financial situation.

"Would you credit it?" reveals stories of how people understand and learn about the terms, conditions and cost of the credit they choose. It provides an insight into borrowing on a low income and raises questions about the impact and extent of financial capability within low income communities.

This report argues that enhancing financial capability within a low income community is complex. Not only does it involve much greater financial advice and personal support, it also involves assisting people to access more affordable credit alternatives.



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