Facing the Squeeze 2011

A qualitative study of household finances and access to credit

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findings *October 2011*

From the late 1990s to the late 2000s the UK enjoyed a prolonged economic boom. Increased expectations about standards of living, supported by a dramatic growth in the mainstream consumer credit market and an expansion of the UK sub-prime market had helped to fuel a significant growth in consumer spending and borrowing. The global financial crisis that first emerged in 2007 heralded the end of this era and in late 2008 the UK entered recession for the first time in 18 years. Unemployment rose, inflation climbed to twice the Bank of England target rate and the UK saw a severe constriction in consumer and business lending. The UK came out of recession in late 2009 and since that time, the Bank of England base rate has stood at an historical low. UK households still faced a difficult macroeconomic climate in 2011, however, with unemployment and inflation remaining high and real incomes falling.

Methodology

Thirty depth interviews were undertaken with adults living in a household on a low or middle income. A **low income** was defined as being at or below 70 per cent of national median income; a **middle income** was defined as being between 90 per cent of the median and the median.

All interview participants were aged 18 to 55 and were using one or more unsecured credit products.

Only those who self-reported keeping up with all their household bills and commitments at recruitment were invited to take part. They included people who said they were keeping up without difficulty and those who were keeping up but said that it was a struggle to do so.

This qualitative study was undertaken in summer 2011 to explore the range of ways in which households on low and middle incomes have been affected, directly and indirectly, by changes in the macroeconomic situation of the UK and the strategies they have used to cope with these changes. The study had a particular interest in the role of attitudes towards spending, borrowing and patterns of money management and credit use in response to such changes as well as the perceived availability of unsecured and mortgage borrowing. Although the main focus was on how households' circumstances, behaviours and attitudes had changed in the previous 12 months, the study found that changes occurring more than 12 months previously continued to influence them.

The study evidenced a diverse range of household financial circumstances and experiences, and despite self-reporting 'keeping up' several participants lived in households that were in fact in some degree of financial difficulty.

Many of those who were managing were, nonetheless, 'feeling the pinch', seemingly only able to maintain this by cutting back on their spending

Households' overall financial situations fell into three broad groups: those who were managing, those who were stretched and those who were overindebted. Despite their apparent security, many of the households that were managing were, nonetheless, 'feeling the pinch' financially. Those who were stretched had struggled to meet some of their financial commitments or were relying increasingly on credit to do so. Some of them had temporarily delayed making certain payments, indicating that they were overstretched and in the early stages of financial difficulties. For the third group of households, those who were overindebted, their difficulties were evidenced by deprivation, structural arrears, or both.

The situations described by the study participants appeared in many respects to reflect a continuation, in real time, of the findings from a similar study undertaken in summer 2009. This was most apparent in the changes participants' households had experienced in the previous 12 months and two to three years. Some had experienced multiple drops in income in that time (some large, some small), others had stabilised or even improved after a prolonged period of difficulty (including unemployment). It was also reflected in the near-universal perception of the rising cost of living, to the extent that some felt they were spending the same amounts as a year earlier despite cutting back on what they bought.

Rather than 'precautionary restraint', the changes that households were making in their everyday spending reflected the recent or more prolonged changes in their spending power

Participants had used a diverse range of strategies to adjust to their changing financial situations. At the forefront were strategies to cut back on spending, by shopping 'smarter' or cutting back on non-essentials. Unlike the 'precautionary restraint' observed in the 2009 study, the changes made by the 2011 participants were making were seemingly in response to recent or more prolonged reductions in their spending power. Nonetheless, these strategies, many of them signs of good money management techniques, appear to play an important role in explaining why households were able to manage reasonably comfortably.

Where households were cutting back on essentials, this included buying only basic foods, cutting back on car use and being conscious not to waste gas and electricity. More extreme examples included selling one or more cars (and instances of this leaving the household without any access to a car) and supplementing home-cooked meals with discards from work. Despite the circumstances in which households had taken these measures, some participants nonetheless described the approaches they were using in a positive light.

Cutting back on spending was often combined with closer money management techniques, such that some participants knew how every last penny would be spent. Although it was unusual for participants to describe having saved at all in the last 12 months, a few had started 'saving up' for particular things they would previously have paid for using credit. As a newly adopted approach, this might pave the way towards a saving habit for these households.

While they were using credit cards, overdrafts or store cards with the same frequency and for the same reasons as they had been previously, they were finding that they were not clearing the balance as they had been in the past

Despite widespread efforts to tighten their spending and money management, there was considerable evidence that households were continuing to rely on unsecured credit, and increasingly so in some cases. This was sometimes attributed to having made large one-off purchases, typically via a personal loan or finance. But it was more often because credit card and overdraft balances had crept up as a result of everyday expenses. While some participants were using credit cards, overdrafts and store cards with the same frequency and for the same reasons as they had previously, they were not clearing the balance as they had in the past. This was a source of frustration, and several acknowledged that they had not adjusted their spending and credit use quickly enough when their situations first changed.

Where households had reduced what they owed or avoided accruing more borrowing this often reflected considerable efforts to cut their spending, reduce waste and manage money closely, in combination. Some were relying on informal borrowing or help in kind and others were simply 'going without'. Sometimes these changes were the result of being credit-constrained (real or perceived). But equally, for others they reflected a self-imposed constraint, by cancelling credit facilities to limit spending power or by avoiding using credit for non-essentials, when they might previously have resorted to using commercial credit for these.

No one in the sample reported overpaying their mortgage, either in anticipation of future increased costs or in response to a reduction in the contracted repayment amount

While homeowners were generally keeping up with their mortgage payments, this reflected a tendency to prioritise housing costs over all other things. Where repayment amounts had fallen, this eased the difficulties some had previously experienced. Rather than being saved, however, the extra money had been used to meet other expenses or absorbed by the rising cost of living. As such, households were not making provision for potential increases in repayment amounts, so that any future increase in cost would have to be funded from those same squeezed budgets. Furthermore, some of the mortgage holders appeared to be relying – indirectly at least – on the historically low Bank of England base rate in order to make ends meet.

In contrast, the study evidenced the relative financial security afforded to households living in social housing, or those in receipt of welfare benefits and tax credits. For some participants, this feeling of security was tempered by their anxieties about losing eligibility for these benefits, however.

Some people implied that they were actively retaining unused credit due to uncertainty about whether they would be able to access new borrowing if and when they needed it

More generally, there was a widespread perception in 2011 that mainstream consumer credit was difficult to access and expensive. There was also a consciousness of – even concern about – the importance of credit ratings. This emerged in several ways: in the recognition that households' circumstances influenced access to and the cost of credit; in encouraging the active retention of unused credit; some participants being deterred from making new applications for fear that a refusal would damage their credit ratings; and others using the sub-prime market because they (perceived that they) did not have a good credit rating. It also deterred people from seeking debt advice.

The study findings strongly suggest there is a need for greater awareness of the signs of financial strain that are indicative of, or even risk factors for, financial difficulties among people with modest incomes. Similarly, there appear to be gaps in people's understanding about what money and debt advice services exist, what they can offer and to whom. In particular there is a need to address an apparent misperception that advice-seeking *per se* can damage someone's credit worthiness. Only with a clearer understanding, will people be in a better position to self-identify as being in or at risk of financial difficulty and able to benefit from advice – before they feel they have reached crisis point – and therefore self-refer to the advice services that are appropriate to them.

It was primarily a perceived lack of need that meant most had not sought advice. However, some felt they did not need advice because they weren't "really struggling", despite showing signs that they were indeed stretched or even overstretched

The evidence suggests that the earlier people identify and adjust to change the better able they are to manage financially, at least in the short to medium term. However, the longer-term sustainability of the strategies households employ to cope with these situations – whether increased reliance on credit, cutting back on spending or drawing down savings – remains unclear from the evidence. There appears therefore to be a greater role for advice services, working in partnership with other key organisations to provide preventative money and debt advice to those facing potential drops in income, whether large (redundancy) or small (reduced hours and pay cuts).

The evidence also points to the continued need for Government to provide the security that many low and middle income households currently rely on in order to get by. These include: welfare benefits, tax credits and social housing; low interest rates; and policies to increase lending to individuals. The strain described, almost universally by participants, from the increased cost of living underlines the potential role that fiscal policy could play in helping to relieve the chronic pressures many households are experiencing. Moreover, the evidence highlights the continued need for government support for free-to-client advice services through centralised funding.

Further information

Andrea Finney is a Senior Research Fellow and Sara Davies is a Research Associate at the University of Bristol's Personal Finance Research Centre. The study was made possible by funding from Provident Financial; we are grateful to them for granting us complete intellectual control in carrying it out.

This summary is based on the full report:

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The full report and methodological appendices and available for download from **www.pfrc.bris.ac.uk** and from the Money Advice Trust's Information Hub at www.infohub.moneyadvicetrust.org

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