

Paying to be poor:

Uncovering the scale and nature of the poverty premium

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The authors take full responsibility for the contents of this report and any errors it may contain.

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Executive summary

Introduction

The notion of the poverty premium was first conceived by American sociologist David Caplovitz in 1963. The term is used to describe how poor people pay more for essential goods and services compared to those not in poverty. In the UK the poverty premium has been highlighted as an important social policy concern by charities and organisations working with low-income families. In 2010 Save the Children illustrated the nominal cost of the poverty premium at £1,300 per year and showed how those on low-incomes paid more for fuel, telecommunications, insurance, accessing cash and accessing credit.

This study makes a significant contribution to moving forward our knowledge of the poverty premium in the UK. It takes a fresh look at understanding why the poverty premium arises and analyses new consumer data to show how the poverty premium is actually experienced. By measuring the proportion of low-income households exposed to a range of additional costs we estimate the average annual cost of the poverty premium. A segmentation analysis of low-income households' patterns of exposure to the poverty premium provides a more detailed understanding of how the poverty premium is experienced (with estimated costs). Through understanding the components of the poverty premium in detail and how they affect low-income households, we identify where action needs to be focused.

The research draws on: a literature review of poverty premium research, a desk-based review of market sectors, focus groups with low-income households and a survey of low-income households (defined as having a household income of 70 per cent of median or below).

Understanding the poverty premium

Based on the literature review and desk-based research of current market provision we identified six key cost areas where the poverty premium arises today: household fuel, telecommunications, insurance, food / grocery shopping, access to money and use of higher-cost credit. In understanding the underlying pathways and

mechanisms by which these premiums arise we identify three sets of factors:

Demand-side factors which reflect low-income households' preferences, needs and circumstances such as having constrained finances, the need for close budgeting control, low usage and risk aversion to actions that might upset tight budgeting control.

Supply-side factors which reflect how markets shape the choices available to consumers and impose additional costs on them. They include higher prices that reflect the additional cost of supplying low-income consumers, specific market failures where products do not meet the needs of low-income groups and general market practices where uncompetitive or unfair practices hit low-income consumers hardest.

Compounding factors that do not sit clearly on either the demand or the supply side, but mediate or compound the relationship between them, such as financial and digital exclusion and geography.

We conclude our understanding of the poverty premium by analysing the extent to which these underlying pathways are driven by consumers' preferences and needs, or are imposed on consumers by structural or other supply-side factors. We then present a new framework of **eight types** of poverty premium that captures these underlying drivers and reflects a balance between premiums being **imposed** on households or occurring more or less by **choice**. Within this framework, there are a total of 29 individual premiums, which range in cost from £9 to £317. These are discussed in more detail below.

Experiencing the poverty premium

We draw on the findings from the focus groups and survey of low-income households to understand how people actually experience the poverty premium.

1. Use of fuel prepayment meters (imposed)

Prepayment meters are a more expensive way of paying for domestic fuel compared to paying by monthly direct debit. Even those who switch to the best prepayment meter tariffs pay more. Around a third of low-income households in our survey used prepayment meters: 32 per cent for electricity and 27 per cent for gas, with 26 per cent for both. Tenure was a particularly distinguishing factor, with prepayment meter use being most common among those living in

social housing. While most customers had prepayment meters imposed on them directly by suppliers or landlords, some were happy with this because of the control they felt they gave them over how much energy they used and prevented them from using more than they could afford. This suggests a failure within the sector for payment methods which meet the needs of low-income customers without also penalising them financially.

2. Use of non-standard methods of bill payment for fuel and insurance (choice)

A minority of low-income households in our survey (seven per cent) paid for their electricity or gas on receipt of monthly or quarterly bills (standard billing) and preferred to pay this way than by monthly direct debit (which is cheaper) in order to retain control of their spending. In relation to insurance, around a third of low-income households paid for their car and home contents insurance monthly (which incurs a premium) because they could not afford to pay annually upfront.

3. Not switched to the best fuel tariff (imposed and choice)

The cheapest fuel tariffs are fixed-term deals paid by monthly direct debit. To get these requires consumers to regularly switch. We consider not switching to be a poverty premium as lower-income households are less likely to switch and higher rates of digital exclusion make it more difficult for them to do so. Three-quarters (73 per cent) of low-income households in our survey had not switched fuel supplier in the last two years, and this was higher still among the digitally excluded (83 per cent). Reasons for not switching included risk aversion and the need to retain tight budgeting control, underpinned by the complex tariff structures within the energy market. Those on prepayment meters, or who pay on receipt of bill are excluded from the best tariffs, even if they chose to switch.

4. Paper billing for fuel and telecommunications (choice)

Around a quarter of low-income households in our survey received paper bills for their gas, electricity and landline and/or broadband, with 13 per cent receiving a paper bill for mobile phones. While paper billing can result in additional charges, some respondents preferred to receive paper bills because of a lack of confidence and skills in using the internet and to have their bills in 'black and white' to facilitate record-keeping.

5. Area-based premiums including insurance and access to affordable shops (imposed)

Area-based premiums relate to higher premiums for insurance cover in higher risk areas, where low income households are more likely to live, and greater difficulty accessing good value shops in more deprived (and poorly served) areas. As such, they derive largely from structural supply factors outside households' control. Overall, 14 per cent of low-income households in our survey had difficulty accessing good value shops (rising to 21 per cent among households without a car) and half had home contents or car insurance (52 per cent each).

6. Insurance of individual household items and mobile phones (imposed and choice)

Insurance of individual items encompasses policies for white goods and other household appliances and mobile phones. These can be an expensive way to insure goods compared to taking out comprehensive home contents insurance, but offer an option when households cannot afford to access comprehensive home contents insurance or where the cost of cover is excessive compared with their need for only low levels of cover. Household appliance insurance was held by 13 per cent of low-income households in our survey. A similar number held mobile phone insurance (16 per cent). Those who held policies for individual items generally believed they were worth having either due to the need to replace a lost or broken mobile phone frequently or because the item was considered vital that they could not afford to be without if it broke down. However, a significant minority of low-income households (16 per cent) were apparently over-insured (holding both home contents and individual-item insurance), which raises questions about the effectiveness of this market.

7. Access to money (imposed and choice)

Access to money has three components: the use of fee-charging cash machines; the use of fee-charging cheque-cashing; and the use of prepaid cards as an alternative to a debit or credit card. A quarter (27 per cent) of low-income households in our survey had used fee-charging cash machines at some point in the last year, compared with only four per cent who had used fee-charging cheque-cashing services, and three per cent who had used prepaid cards.

8. Higher-cost credit (imposed and choice)

The use of higher-cost credit is driven largely by financial exclusion, lack of affordability, borrowing small amounts, and a desire for close

budgeting control with small weekly payments. Use of higher-cost credit was not common, just 16 per cent of low-income households in our survey said they had used higher-cost credit in the last 12 months (across the eight different types of credit we identified). Overall, it was something that low-income households tried to avoid using.

Counting the cost of the poverty premium

We estimate that the average cost of the poverty premium is **£490** per household per year. This is lower than the previous estimate of around £1,300 per year (Save the Children, 2010). This difference largely derives from the way that the average premium for each component takes into account the proportion of households incurring it. In other words, our model doesn't assume that all low-income households incur all premiums.

The contribution of each component to the overall poverty premium derives from both its incidence and the cost of the premium. In other words, some components are problematic because a large number of low-income households incur a poverty premium (i.e. they are broad). Others are problematic because a small minority of households incur a very large premium (i.e. they are deep). And others still, such as failing to switch fuel supply, are problematic because large costs are incurred by large numbers of low-income households (i.e. they are both broad and deep).

The largest share of the average poverty premium experienced by households by far – at £233 per year – is accounted for by not being on the best fuel tariff. The next largest share, at £84 per year, is made up of area-based premiums: this is largely accounted for by premiums related to car insurance and difficulties accessing good value shops. Higher-cost credit, at £55 per year, makes up a further £11 in every £100 of the premium, followed by use of prepayment meters (£38 per year), a preference for non-standard billing methods (£33 per year), and insurance for individual items representing £6 in every £100 (£27 per year). Finally, paper billing (£12) and access to money (£9) contribute the least to the overall poverty premium at just £2 in every £100 (see Table).

Table: Share of the premium annual poverty premium cost by premium type

Premium type	Low-income households incurring this %	Average premium per low-income household £ / year	Average premium as a share of the total %
Use of prepayment meters	33	£38	8
Non-standard billing methods	50	£33	7
Not switched to best fuel tariff	73	£233	48
Paper billing	49	£12	2
Area-based premiums	73	£84	17
Insurance for specific items	23	£27	6
Access to money	29	£9	2
Higher-cost credit	16	£55	11
Total	99	£490	100

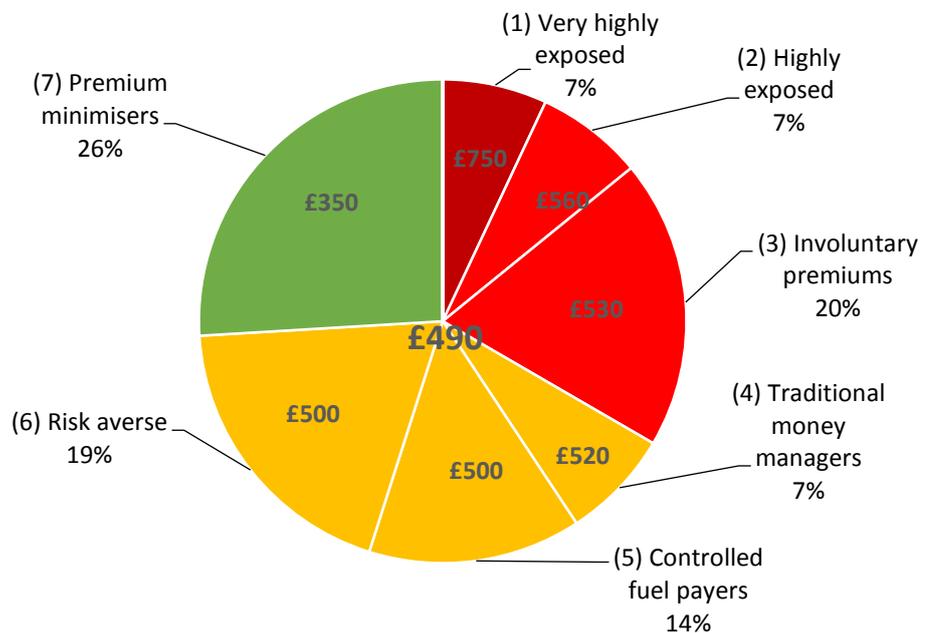
Source: Survey, n= 947, weighted. Note. Figures may not sum correctly, due to rounding.

Patterns of exposure to the poverty premium

Exposure to the poverty premium and the costs incurred by low-income households are highly nuanced. We have identified seven distinct clusters representing the most dominant patterns, or combinations, of poverty premiums experienced by low-income households (see Figure).

A quarter of low-income households in our survey incurred an average premium of £350 per year. A further two clusters each incurred an average of £500 with further clusters spending an average of £520, £530 and £560 on the poverty premium each year. The analysis identified a small cluster of low-income households (seven per cent) who are very highly exposed and incurred an average annual premium of £750 (1.5 times the premium for low-income households as a whole).

Figure: Seven clusters of exposure to the poverty premium



The *types* of poverty premiums that each cluster is exposed to varies as well. The most highly exposed households were defined by prepayment meter, insurance and high-cost credit premiums and tended to live in homes rented from housing associations (suggesting they are among the poorest of households), in their family years (suggesting they have some of the highest demands on their incomes) and internet active (suggesting they may already have been doing what they could to shop around and switch deals online where possible).

It is important to highlight, however, that even within each cluster, some low-income households were at risk of incurring a much higher premium than the cluster average (and others less). In one illustrative example (based on a real ‘very highly exposed’ household surveyed - Cluster 1), the calculated premium was £1,860 on a total annual household income of only £16,500.

Conclusions and implications for policy

This research has estimated the average cost of the poverty premium at £490 per year in 2016. However, low-income households varied in their exposure to different premiums, and the premium could be as much as £750 for some households. As such, the methodology used

here has provided a more nuanced measurement of the premium poverty premium than has been possible in the past.

The largest share of the average premium incurred by low-income households related directly to low-income households' not being on the best household fuel tariff - a fixed term deal paid by monthly direct debit. This was compounded by other, albeit much smaller, premiums associated with households' fuel payment methods. In addition to fuel, other components of the poverty premium which contributed comparatively large amounts to the average premium were associated with insurance (particularly car insurance) and difficulties in accessing low-cost supermarkets. Although it was unusual for households to have used sources of high-cost credit (only 16 per cent had), those who did incurred the highest costs overall – up to £540 per year for some types of borrowing.

The findings of this research suggest that there is still scope – and, in cases, substantial scope – for the poverty premium to be reduced, and there is a role for providers, government and regulators to help address it. Central to the solution may be striking a better balance between cost-reflective pricing and cross-subsidy (where cross-subsidy is possible) and roles for greater partnerships and involvement of trusted intermediaries. The clearest priorities for action relate to insurance, higher-cost credit, and fuel.

For insurance there is a role for low-cost, 'low-frills' products which are reflective of lower levels of cover needed. The poverty premium associated with car insurance is particularly high, and the more providers can move towards risk-based pricing which, for example, rewards drivers based on their behaviour, the more scope there may be for reducing prices to those living in higher risk areas. The additional cost of paying for car and home contents insurance monthly and the extent to which this premium is cost-reflective may also need investigating.

Although high-cost credit is not widely used, when incurred, the premiums can be very high. The high cost of rent-to-own stores, home collected loans and subprime personal loans suggests these are particular areas for future investigation by the Financial Conduct Authority. There is still an unmet need for low cost micro loans for financially excluded consumers and a role for social investors, financial institutions, charities and Government to work together to develop a larger-scale offer of affordable credit alternatives.

Reform of the fuel market is a priority area for addressing the poverty premium. The additional cost for customers on prepayment meter tariffs remains an issue and in this respect the Competition and Market Authority's proposed temporary price cap on prepayment tariffs (CMA, 2016) is to be welcomed. However, the much greater issue is the penalty low-income households incur for not switching. The need for consumers to be vigilant and active in the energy market to obtain the best deals penalises low-income households who have valid reasons for not switching. Our findings suggest that the Competition and Market Authority's proposals to increase engagement in the energy market will not be sufficient to eradicate the fuel poverty premium. The alternative solution is for market regulation that prevents energy companies from leaving customers on expensive standard tariffs when much cheaper tariffs are available. Another solution proposed (JRF, 2016b) is the encouragement and promotion of collective switching schemes that are able to negotiate a better deal from energy suppliers and support customers to switch.

Central to tackling the poverty premium is recognising that low-income households have particular needs around the way they manage their money and that products and services designed for middle or higher-income customers may automatically disadvantage them. As such, the poverty premium in some areas is underpinned by lack of true market competition and innovation which meets the needs of low-income consumers, which can only be addressed through the collective commitment of industry, policy makers and regulators.

1 Introduction

The notion of the poverty premium was first conceived by American sociologist David Caplovitz in 1963. The term is used to describe how poor people pay more for essential goods and services compared to those not in poverty.

In the UK the poverty premium has been highlighted as an important social policy concern by charities and organisations working with low-income families. The profile of the issue was raised considerably in 2007, with the publication of research to estimate the cost of the poverty premium by Save the Children and the Family Welfare Association (2007).¹ This landmark study illustrated the nominal cost of the poverty premium at just over £1,000 per year, and this was later revised to £1,300 in an update of the work in 2010 (Save the Children, 2010). It showed in particular how those on low-incomes paid more for fuel, telecommunications, insurance, accessing cash and accessing credit.

This study makes a significant contribution to moving forward our knowledge of the poverty premium in the UK by providing a framework for understanding not only what the costs are but *why* they arise, what the *felt experience* of them is and, uniquely, *how many* households are affected by it. While this study provides a timely update to earlier research, that reflects markets and household behaviour as it exists today, it also moves beyond a nominal illustration of the cost to provide a more realistic estimate of the poverty premium as it is actually experienced by low-income households. For years, researchers have described the way that people on low-incomes can pay more for their goods and services. Now, for the first time, we are exploring how many low-income households are actually affected by the poverty premium, and by how much.

1.1 Background

Poverty is – at its simplest – the lack of resources (Townsend, 1979). Measures of it are based on a relative concept of poverty whereby those who are poor are unable to have a standard of living that is

¹ Referred to as Save the Children 2007 hereafter.

considered acceptable in relation to typical standards of living among wider society (UN, 1995).

The significance of the poverty premium is that it adds to the difficulties low-income households face in making ends meet and exacerbates poverty. In low-income households, even small amounts of extra income can make a difference.

“... when poor families’ incomes rise, parents spend those gains on essentials for themselves and their children”. (Save the Children, 2007, p.1).

Crucially, while not all poorer households incur a poverty premium when paying for different goods and services, their low-income puts them at greater risk of doing so *and* places a disproportionate burden on that income if they do. For some households, however, the reality of the poverty premium may be that they avoid incurring these costs altogether by ‘going without’ (e.g. Anderson et al., 2010; Gregory, 2015).

The importance of tackling the poverty premium is recognised in the Joseph Rowntree Foundation's recent strategy for solving poverty in the UK (JRF, 2016a). It identifies ending the poverty premium as a key component of this strategy to reduce the cost of essential goods and services for poor people, alongside measures to increase household income.

Previous studies have taken a range of different approaches to understanding how the poverty premium arises. This includes studies which have:

- drawn indirectly on prior research about how low-income households manage their money and access services (Tinson 2014; Save the Children, 2007);
- undertaken qualitative research with householders living in poverty (Save the Children, 2010; Perry, 2010; Toynbee Hall, 2014; MacBride and Purcell, 2014);
- analysed UK expenditure data (Bevan, 2009; Richards, 2015);
- conducted consultations with stakeholders (Macbride and Purcell, 2014; Bevan, 2009);
- analysed regulations which potentially affect the poverty premium (Hirsch, 2013); and

- produced cost comparisons for particular areas of expenditure to estimate the premium (Save the Children, 2007, 2010; Hirsh, 2013; Toynbee Hall, 2014).

A recent report from CAB Scotland (Davidson et al., 2016) has quantitatively and qualitatively explored and measured the way in which the behaviour, attitudes and decisions of low-income households influence purchasing decisions and the resulting level of the poverty premium experienced, as well as exploring their interactions with telecom, energy and credit providers. As a result, there is a comprehensive body of evidence which considers a range of cost areas in which a poverty premium is likely to arise, and an understanding of why it arises, that this study has been able to draw and build on.

1.2 About this study

This study is ostensibly an update of the poverty premium to reflect recent changes in consumer markets, for example the growth in discount supermarkets, and developments in mobile phone technology and changes in the regulatory landscape, such as controls on payday lending and domestic energy tariffs. As such, this study represents the poverty premium as it exists today. However, it also extends beyond a simple update and differs from previous poverty premium research in three key ways.

Firstly, it takes a completely fresh look at understanding why the poverty premium arises. Through reviewing previous research and collecting new qualitative data we have been able to identify not only which areas of expenditure are affected by the poverty premium but why different premiums arise and the underlying conditions that make low-income households vulnerable to experiencing them. This has enabled us to develop an overarching conceptual framework for understanding the poverty premium.

Secondly, through collecting new qualitative and quantitative data we are able to show how the poverty premium is actually experienced. For each poverty premium that we have identified we have calculated a nominal cost, and by measuring the proportion of low-income households exposed to each premium we have estimated the average, experienced, cost of the poverty premium.

Thirdly, we have delved below average exposure to the poverty premium and conducted a segmentation analysis of low-income households based on their patterns of exposure to it. Therefore, rather than assume that all low-income households have the same experience, we offer a more detailed and nuanced understanding of how the poverty premium is experienced by low-income households. In doing so, we identify seven different patterns of exposure to the poverty premium and for each we provide an estimate of the cost these households incur.

Ultimately, through understanding the components of the poverty premium in detail and how they affect low-income households, this research aims to identify where action needs to be focused to eradicate, or at least reduce, the poverty premium and we suggest solutions for doing this.

A key feature of this research is that we have extended our analysis of the poverty premium to cover **low-income** households: defined in this study as households with an income of 70 per cent of median income or below (after housing costs). This definition is higher than the standard 'poverty line' measure of 60 per cent of median income, used in the UK and other European Union countries to classify people as poor. As such, we use the term 'low-income' households to describe the population affected by the poverty premium, rather than households in poverty per se. This slightly higher threshold allows us to include in the research households who are on the fringes of poverty (and may be just emerging from, or falling into poverty), who are still likely to find it hard to make ends meet and may, therefore, share some of the same risk factors for incurring a poverty premium as households living in poverty. In particular this higher income threshold extends the research to include more low-income pensioner households, who are less likely to fall below the official poverty line. This is discussed further in the Technical Appendix.

1.3 Research design

The research was a mixed methods design comprising five elements:

- A literature review of previous research on the poverty premium.
- A desk-based review of the prevailing sectors in which the premium has previously been indicated to arise in.
- Focus groups with low-income households to explore their experience of the poverty premium: seven groups were conducted in

total, held across four locations (Glasgow, Telford, London and Bideford) and three age groups (18-25, 26-55 and 65 plus).

- A survey of almost 1,000 low-income households (defined as having a household income of 70 per cent of median or below) carried out by Ipsos MORI on their face-to-face omnibus survey.
- A desk-based costing exercise to source representative costs for each component of the poverty premium.

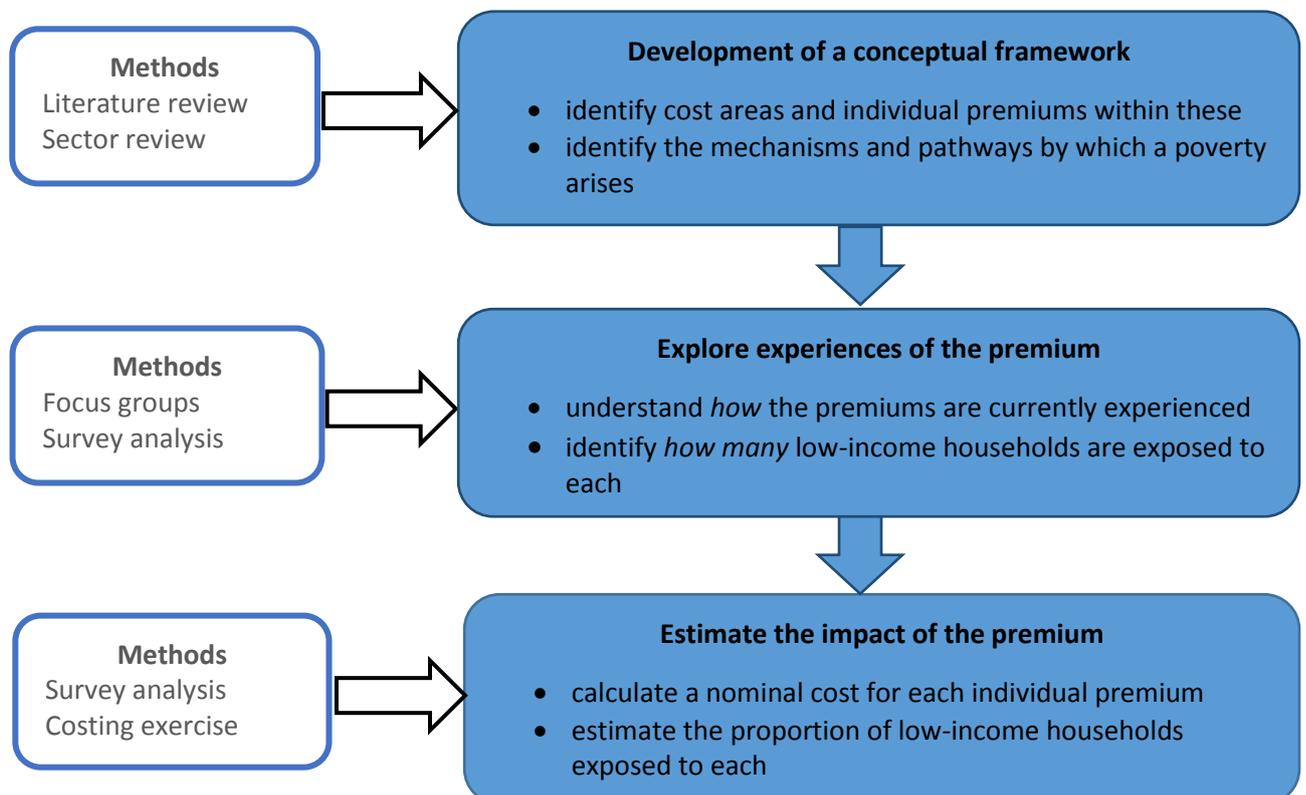
Further details about the research methods are provided in the Methodological Appendix.

These four research elements fed into the following separate, but linked, phases to the research, as illustrated in Figure 1.

1. The development of a conceptual framework for understanding the poverty premium.
2. Exploration of experiences of the poverty premium as it exists today.
3. Estimation of the impact of the poverty premium by calculation of the average costs of it for different households.

A stakeholder group was also convened to provide expert input at each stage of the research.

Figure 1. Research design



1.4 Report structure

Chapter 2 presents our conceptual framework of how the poverty premium arises. We identify three sets of drivers: demand-side factors, supply-side factors and compounding factors. Chapter 3 describes low-income households' experiences of the poverty premium, drawing on our findings from the focus groups to illustrate how and why it is experienced, and on our findings from the survey to illustrate how many low-income households experience it. In Chapter 4 we present our cost calculation of the overall average poverty premium and analyse how this is comprised. We identify poverty premiums that affect the largest proportion of low-income households, those that incur the highest cost and those that do both of these. Chapter 5 presents the findings from our cluster (or segmentation) analysis to show how different types of household are exposed to different combinations of poverty premiums and presents illustrative costs for these different levels of exposure. Finally, in Chapter 6 we summarise how the poverty premium exists in Great Britain today and look at the policy implications for reducing it.

2 A framework for understanding the poverty premium

Already described, the poverty premium is the notion that the 'poor pay more' for essential goods and services (David Caplovitz, 1963). For the purposes of this report, we can understand the poverty premium to occur for one or more of three key reasons:

- Additional costs directly resulting from having a low income, for example because this reduces the flexibility of payment methods;
- Additional costs associated with a low income even though not directly resulting from it, for example the additional chance that someone on low-income lives in a high-crime area where insurance premiums are high; and
- Additional costs that can be experienced by people across income groups, but are more likely to be experienced by lower-income households, such as not "shopping around" for utility tariffs, and which place a disproportionately high burden on low-income households' resources.

These play a role to a greater or lesser extent in the various factors which can lead to a poverty premium, and all three are represented in the poverty premiums we explore in this chapter. We briefly identify the poverty premiums which exist today, based on a review of the literature and desk-based research of current market provision. We then explore these components through a conceptualisation of the poverty premium we have developed, in terms of the underlying pathways and mechanisms by which they arise. In doing so, we identify several demand-side, supply-side and compounding factors, and note how these often interact to produce tangible premiums. We conclude by categorising the premiums which exist today based on a framework which reflects the balance of the underlying contributory pathways; that is whether they are largely driven by consumers' preferences, and needs or imposed by structural or other supply-side factors.

2.1 Components of the poverty premium

The early research which calculated an illustrative poverty premium for the UK highlighted household fuel use, telecommunications, insurance, shopping for food and groceries, accessing cash and accessing credit (which manifests in the use of higher-cost credit) as the six key areas of costs affected (Save the Children, 2007; 2010). These cost types have largely remained the key areas of focus in the main poverty premium research undertaken in the UK since then (Bevan, 2009, Hirsch, 2013, Toynbee Hall, 2014; Tinson et al., 2014; MacBride and Purcell, 2014; Gregory, 2015; Davidson et al., 2016).

However, some studies have gone further and identified poverty premiums in other areas of household expenditure. For example, they have included water bills (e.g. Cambium Advocacy, 2015), the costs of Christmas (Family Action, 2009), providing for school uniforms and related educational expenses (The Bevan Foundation, 2009), buying bulky goods such as furniture and white goods (McBride and Purcell, 2014), and the costs of public transport particularly for those living in rural areas and peripheral housing estates (Kempson and Collard, 2006).

We have reviewed the importance of these cost areas to the poverty premium overall, based on the previous literature and the extent to which current markets suggest premiums continue to exist within these areas. Based on this, we have prioritised six prevailing cost areas previously identified in poverty premium research:

- Household fuel
- Telecommunications
- Insurance
- Food and grocery shopping
- Access to money; and
- Higher-cost credit

In relation to household fuel, for example, we have found that premiums persist as a consequence of how people pay for their fuel, receiving a paper bill (since our research shows three of the 'Big Six' offer a discount for paperless billing) and not switching fuel provider or tariff regularly. However, we have not included a premium to reflect prepayment meters removal charges because there is strong evidence to suggest these are being phased out by the industry (Ofgem, 2015b). And we have not included standing charges for fuel

as previous studies may have done, as our research has shown that there is currently a wide availability of tariffs for all payment methods which do not include standing charges.

Meanwhile, telecoms is a market that has changed markedly in recent years. In particular, there is widespread availability of individual service and packaged telecom deals,² and research has found that this is a market in which consumers are able to engage and negotiate good value deals (Richards, 2015). Pay-as-you-go mobile phones, previously considered as a core component of the poverty premium, are now highly competitive. As such, we have excluded standing charges for landlines and pay-as-you-go mobile phones and included a charge for paper billing as the only element now included in the poverty premium for telecoms.

For a fuller consideration of individual cost components areas identified in previous research but which our research has led us to exclude from our poverty premium calculation please see the accompanying Costing Methodology Appendix. These include cost areas (such as the cost of Christmas) which we feel are better captured more directly through other cost components (such as in the use of higher-cost credit).³

In other instances, markets may have changed but concerns about a poverty premium nonetheless persist. For example, the introduction of a cap on the total cost of credit and new regulations for payday lending in January 2015 may have gone some way to reducing very high costs associated with higher-cost borrowing, albeit only in relation to this market.⁴ However, there is evidence that customers continue to be treated unfairly and that there is increased availability of slightly longer-term loans (of three to six months; Citizens Advice, 2016). As such, we have identified eight types of higher-cost credit to include in the calculation of the poverty premium:

- rent-to-own for the purchase of durable household appliances;
- payday loans;
- home-collected loans (sometimes called doorstep loans);

² Covering line rental, broadband, phone call and TV channels.

³ It is worth noting that there may be other components which we cannot adequately account for.

⁴ The report of the Competition and Markets Authority investigation into the payday lending market published in February 2015 concluded that there were 'significant limitations in the effectiveness of competition between payday lenders on prices' (CMA, 2015; p8).

- subprime personal loans;
- loans from a pawnbroker;
- subprime credit cards;
- mail order catalogues which do not require a good credit rating; and
- Christmas hamper food schemes (paid up front by instalment).

We have also considered new components which have not been identified previously, such prepaid plastic cards.

In total, we have identified 29 measurable poverty premium components, from the six initial areas of expenditure considered. And we have reviewed and revised the assumptions underpinning how these premiums are calculated (described in the accompanying Costing Appendix). We revisit these premiums below to understand why they arise, and summarise them in Box 1 at the end of this chapter.

2.2 Pathways to the poverty premium

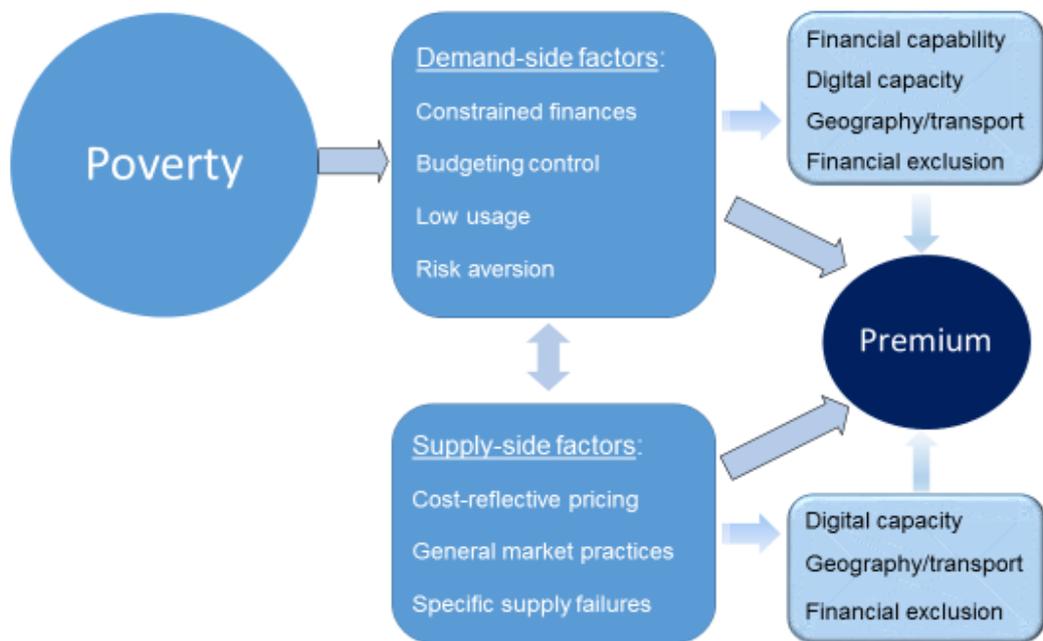
Some individual premiums, such as the historical premium associated with prepayment meter use for fuel (which persists as a premium compared with direct debit accounts although the prices for prepayment meters have largely been aligned with standard billing tariffs; Ofgem, 2011), may appear to arise more or less obviously and directly. Others, in contrast, such as an insurance premium which implicitly reflects the area in which a low-income household lives, appear to reflect more indirect factors. A crucial objective of this project therefore has been to understand not only what poverty premiums arise, but *why* they arise, and what the underpinning causes and likely pathways are to them.

When looking across the components of the poverty premiums, our review of the literature suggests several underlying drivers and these include the importance households place on certainty of costs and a need to retain control, and a fear of the consequences if they place their trust in a new provider or payment method. It appears that a premium can arise because of the particular preferences of low-income households, for example, to facilitate record keeping, or because low-income households cannot afford to – or do not know how to – capitalise on cheap deals or more cost-effective ways of buying goods. And there are instances in which certain premiums may be largely imposed on households by providers, such as fuel prepayment meters.

Overall, we have been able to identify two main sets of factors which play an underlying role in low-income households paying more: **demand-side** factors which reflect a low-income household’s preferences, needs and circumstances; and **supply-side** factors which reflect how supply markets shape the choices available and impose particular costs associated with some. Moreover, a third set of factors may not sit clearly on either the demand or the supply side, but mediate or **compound** the relationship between them.

Within each of these sets, we have sought to identify what the factors are and we highlight the important ways in which these factors combine and interact to produce a poverty premium. Figure 2 illustrates a framework for our conceptualisation of the pathways.

Figure 2 Conceptual framework for understanding pathways to the poverty premium



2.2.1 Demand-side factors

From a demand-side perspective, we have already noted that low-income households, by definition, have constrained incomes, poor capacity to access cash quickly and easily and limited financial safety nets. These constraints mean people on low-incomes struggle to afford goods and services. One response may be for people to go

without these products and services (Anderson et al., 2010; for example, in relation to household insurance), but in many instances this may be neither possible nor desirable. Instead the question becomes what to buy, how much to buy and how to buy it.

We have identified four, prevailing demand-side factors, which directly and disproportionately affect low-income households and underpin many of the poverty premiums incurred.

Low affordability

Constrained finances make it difficult for low-income households to afford to make large lump-sum payments up-front for goods and services. Households might instead opt to spread the cost of services even if it means incurring additional costs in the long term, such as paying for insurance (e.g. car or household contents), by monthly instalment, as a recent report into spending patterns in low-income households (Richards, 2015) noted. Or they may resort to sources of higher-cost credit which allows them to obtain goods as they need them (OFT, 2010). The use of higher-cost credit has been included in most of the previous poverty premium research literature (Save the children, 2007, 2010; Church Action on Poverty, 2010; Tinson et al., 2014; Toynbee Hall, 2014). Low resources also makes prompt access to money important, which can mean resorting to the use fee-charging cash machines (ATM) or cheque-cashing services.

Budgeting control

Reduced capacity to pay out large sums at a time also means that low-income households have much greater need and desire than other households to put in place mechanisms that help them stay on top of their spending. Indeed, people living in low-income households show comparatively high levels of controlled spending and organised money management (Finney and Hayes, 2015).

This appears important, for example, in relation to shopping for smaller quantities at a time, a preference for cash budgeting (Finney and Hayes, 2015), and for higher-cost borrowing which allows for frequent, small repayments (PFRC, 2013; Collard and Kempson, 2003a/b). The value users of prepayment meters place on their ability to budget fuel use closely and avoid getting into difficulty with their fuel bills has also been underlined (e.g. Save the Children, 2010; Toynbee Hall, 2014; McBride and Purcell, 2014; Gregory, 2015, Davidson et al., 2016). Many household energy suppliers charge a

small fee to customers who wish to receive paper bills in order to retain close control over their record-keeping and budgeting.

Low usage

Low spending power leads low-income households to use or buy products or services less compared with other households. This can result in additional costs. For example, previous research has shown that standing charges represent a way in which low-income households might incur a poverty premium for fuel. This is because they are more likely to be low users and therefore pay more per unit of consumption than higher users, including to cover standing charges (Gregory, 2015). Hirsch (2013) found that low users did relatively worse from pricing structures that placed greater emphasis on fixed rather than per unit charges on fuel or telecommunications. Our own research suggests it is currently less of an issue for these particular sectors, or at least it is extremely difficult to measure.⁵ However, it does emerge more clearly in other areas, for example, in an ability to buy in bulk and therefore to make smaller, more frequent shopping trips (e.g. Anderson et al., 2010). Additionally, low-income households will often need or want to borrow only small amounts of money at a time, resulting in a greater propensity to use credit products such as payday loans and other sources of higher-cost credit, which cost more for lenders to provide (for example through setup and administration costs) relative to the sums lent (PFRC, 2013). It can also apply in relation to home contents insurance, where insurers offer minimum values beyond the value of poor households' goods (Save the Children, 2007) making purchase of single-product cover attractive, even though it can be a more expensive way of insuring goods.

Risk aversion

Limited resources encourage low-income households to disproportionately avoid behaviours which might upset tight financial control, such as switching providers or moving from one payment method (e.g. prepayment meters for fuel) to another (The Bevan Foundation, 2009). It might also involve a preference for paper billing to avoid 'missing' a bill, or a propensity to take out insurance for specific household items (Finney and Davies, 2011) due to concern over not being able to afford to replace them should they break down, even when these might already be covered by a standard home contents policy.

⁵ And it is therefore excluded from our calculation of the poverty premium.

2.2.2 Supply-side factors

Hirsch (2013) describes three supply-side factors relating to the genuine additional costs of serving low-income consumers, as well as those that arise because low-income consumers have a weak position in the market place, relative to other consumers.

Cost reflective pricing

Higher prices reflect the additional costs of supplying low-income consumers. For example, this includes the higher costs associated with fuel payment methods other than direct debit, the cost of issuing paper bills, the cost of collecting insurance premiums monthly rather than as an annual up-front premium, higher insurance risk in more deprived areas and higher risk of default on loans. In the case of high cost credit, high collection costs of home collected loans in particular and the comparatively high administrative costs as a proportion of low-value loans is also likely to play a role in the prices charged by lenders (e.g. Kempson et al, 2009; OFT, 2010; PFRC, 2013).

Specific market failures:

Specific market failures refer to the failure to supply products that meet the specific needs of low-income groups at competitive prices. Some of the needs of low-income households – for example for prepayment meters, low-use, low-cost ('no frills') products and small-sum short-term credit – are not widely available. In particular, lower-cost credit providers do not offer the types of small fixed-term loans low-income households are more likely to need and want. Similarly, low-income households may be more or less limited to individual item insurance if they cannot afford a comprehensive home contents policy or they have low usage requirements in the absence of low-cost ('no frills') policies with low minimum sums covered.

General market failures

General market failures refer to uncompetitive or unfair practices which result in the cross-subsidy of one consumer by another, indirectly or inadvertently hitting low-income consumers hardest. This is particularly the case where accessing the lowest prices involves frequent or sophisticated product and price comparisons and rate-chasing, or where there are complex pricing structures; less active or capable consumers tend to be excluded from the best deals which creates a cross subsidy in favour of better off groups (Hirsch, 2013).

For example, while only 13 per cent of all households had switched fuel providers in the previous 12 months (Ofgem, 2015a), research has shown that low-income households are in a particularly weak market position compared with other consumers and are less able to switch to the best deals (Hirsch, 2013). Those in social grades DE (a proxy for low-income) were less likely to switch (10 per cent) than those in grades AB (16 per cent; Ofgem, 2015a), as were those living in rented accommodation (no figure; Ofgem, 2016).

General market failures can also occur in relation to a general lack of competition in niche subprime markets, such as higher-cost credit. It has been noted that the premiums charged by higher-cost lenders are often greater than is justifiable by the additional risk (of default) when lending to low-income households (Hirsch, 2013; p22). Low-income households often have prepayment meters imposed on them by their suppliers if they have fallen into debt,⁶ but these are not as competitive as other fuel payment methods.

2.2.3 Compounding factors

There is potentially a wide range of factors which compound the factors described above, but which are not necessarily driven by low-income households' needs or circumstances; indeed, these factors have the potential to affect households regardless of income. That said, exposure to them is disproportionately high and has a disproportionate impact among low-income households. We have summarised them under the following headings.

Financial capability

Financial capability reflects “the skills, knowledge and behaviours individuals need to make informed decisions and take positive action about their finances”. Specifically, people living in households in the lowest income quintile are less likely to choose appropriate financial products for their needs (Finney and Hayes, 2015), presumably as a result of their more limited experience of financial services. In a recent review, it was concluded that lower consumer literacy “can leave [people] particularly vulnerable in markets where they need to make complicated choices or where deals are difficult to compare” (CMA, 2015a; p6). This is likely to manifest in poorer capacity to

⁶ And our focus groups showed that they were also sometimes imposed by landlords. See Chapter 3.

understand energy pricing structures and reduce confidence to switch products and services.

Digital inclusion

“[M]ore than not having access to a computer... a sufficient level of digital literacy is required to be able to recognise when information is needed and to have the ability to locate, evaluate and make effective use of the online systems” (The Chartered Institute of Taxation, 2013). Some 42 per cent of people with the lowest incomes do not access the internet, compared with less than one per cent with the highest incomes (Dutton and Blank, 2011), and this can deepen existing social and economic disadvantage (Helsper, 2008). Poor digital inclusion is expected to reduce households’ capacity to compare information and access the best available deals. This is particularly pertinent to switching.

Geography/transport

Where people live and a lack of private transport can make a difference to the goods and services low-income households are able to access. For example, despite some significant improvements, more deprived areas tend to be less well served by free-to-use cash machines (Link, 2013; The Guardian, 2014; Toynbee Hall, 2014) and banks and building societies (French et al., 2013; Reuters, 2016) resulting in use of fee-paying cash machines, or cheques cashing services. Without access to a car, or adequate and affordable public transport, cheaper shops can be hard to access (Toynbee Hall, 2014; Tinson et al., 2014; McBride and Purcell, 2014). A lack of private transport can also make it difficult for households to benefit from bulk-buy discounts of goods and other consumables (Richards, 2015). The geography of low-income households, and the resulting increase in policy premiums paid for car and home contents insurance in high crime risk areas, has previously been identified as a key part of the overall poverty premium (Save the Children, 2010; Kempson and Collard, 2005; McBride and Purcell, 2014; Toynbee Hall, 2014).⁷ For many, household and car insurance will simply be out of reach, and

⁷ In our desk research, the cost of car insurance in one of the 20 per cent most deprived areas of England incurred higher poverty premiums than an area with median levels of deprivation (as defined by the Index of Multiple Deprivation). It is worth noting that the premium increases further (almost doubling) for those in a yet more deprived area (among the 10 per cent most deprived).

they may go without it. Conversely those wishing or having to buy insurance have little choice but to incur this poverty premium.

Financial exclusion

Financial exclusion is the situation in which households have no or limited access to appropriate products and services. It is estimated that 86 per cent of the lowest-income households have a current account, compared to 97 per cent of the highest (Department for Work and Pensions, 2015), but a proportion of these will be only marginally banked, preferring instead to operate a cash budget (Kempson and Collard, 2012). This in turn can make establishing a credit history and accessing mainstream credit sources more difficult and other goods and services may also become difficult (or impossible) to access without a debit or credit card, especially online. The use of fee-charging cheque-cashing services has also been included in previous poverty premium research (e.g. Save the Children, 2010; Toynbee Hall, 2014). This is likely to reflect a greater likelihood that low-income households are not fully banked (and therefore cannot cash a cheque free at a bank or building society) and a need for immediate access to the cash.

2.2.4 The interaction of factors

Importantly, the way that the various demand, supply and compounding factors interact is likely to be central to the nature, scale and intransigence of the resulting poverty premium. For example, a low-income household may pay more for fuel because: they prefer to budget closely (which a prepayment meter affords them); financial exclusion (being unable to pay by direct debit), digital exclusion and low financial capability makes comparing and switching to the best tariffs difficult; and risk aversion makes switching to another provider payment method unattractive. Meanwhile this occurs in the context of complex tariffs and evolving markets and potentially, in relation to prepayment meters in particular, mechanisms imposed by providers or landlords. What we see therefore is constrained choices for low-income households, where there is any choice at all.

As such, there are certain premiums, such as non-standard billing methods (payment of receipt of fuel bills, monthly insurance payments) and paper billing which derive more or less from a choice made by households in an effort to keep in control. In contrast, the use of prepayment meters and the area-based premiums associated

with insurance are factors which a household has very little choice over and are instead imposed on them by markets or suppliers.

We explore this further in the next section.

2.3 Re-framing the poverty premium: imposed vs choice-driven premiums

In light of our assessment of the pathways which contribute to the poverty premium, we can begin to see a slightly different pattern emerging in relation to the areas of expenditure in which poverty premiums have been identified as arising. In particular, we find that we can group individual poverty premiums more meaningfully based less on the sector they relate to and more in relation to *why* they arise. In turn, the reasons why they arise will have clearer implications for how particular poverty premiums might be resolved.

As discussed above, these reasons may, in some instances, primarily reflect a balance towards household choice or preference, as appears to be the case for paper billing. In others, it may be more or less imposed, primarily reflecting instead market structures or failures, such as appears to be the case for area-based premiums. Others, such as insuring specific items, appear to arise equally from a combination of households' preferences and choices and structural factors. Some premiums initially appear less clear cut. For example, previous research (and our own focus groups, which we describe in the next chapter) has highlighted how fuel prepayment meter users often extol the benefits of paying by prepayment meter, and that prepayment meters apparently meet low-income households' needs for close budgeting and risk aversion. Crucially, however, the market nonetheless imposes the higher cost of them on low-income households because it has not yet developed alternative payment methods which both meets the needs of low-income households and allows for the recovery of fuel arrears while also being more competitively priced.

As a result, we have reconsidered the individual poverty premium costs in light of the pathways discussed in this chapter and re-categorised them thematically into eight new premium types. These new categories better capture the underlying drivers which explain low-income households' exposure to them and, for each, we have summarised the balance of causes:

1. **Use of fuel prepayment meters.** These relate to fuel and are premiums which are largely imposed on low-income households by housing or fuel providers through pervasive sectoral structural factors, but also reflects a desire for close budgeting control and risk aversion: **'Imposed'**.
2. **Use of non-standard methods of bill payment (excluding fuel prepayment meters).** These relate to fuel and insurance, and are derived largely from choice driven by a desire to retain control, but are also imposed when households cannot afford to make large upfront payments: **'Imposed' and 'Choice'**.
3. **Not switched to best fuel tariff** Relating exclusively to fuel, particularly by not switching suppliers. While it is ostensibly indicative of households' preferences to retain budgeting control, a risk aversion and poor financial capability it is also underpinned by complex market structures, compounded by digital exclusion: **'Imposed' and 'Choice'**.
4. **Paper billing.** This encompasses fuel and telecommunications and derives largely from choice driven by a desire to retain close budgeting control and facilitate record-keeping: **'Choice'**.
5. **Area-based premiums.** This relates to insurance and access to affordable shops and derives largely from structural supply factors outside the household's control: **'Imposed'**.
6. **Insurance of individual items.** This encompasses policies for white goods and other household items and mobile phones, and is likely to be driven largely by financial exclusion and low usage (and therefore largely imposed on households by market structures) or consumers' risk aversion: **Both 'Imposed' and 'Choice'**.
7. **Access to money.** This is related largely to tenuous financial exclusion, with two of the three component premiums also relating to where people live (that is, factors beyond their control), or a desire for close budgeting control. **Both 'Imposed' and 'Choice'**.
8. **Higher-cost credit.** This is driven largely by financial exclusion but also low usage needs and a desire for close budgeting control. **Both 'Imposed' and 'Choice'**.

We take this new framework forward into the remainder of the report.

The individual premiums making up each category are shown in the Box 1 below, and are defined based on the questions used in our survey to measure exposure to them in the population of low-income households. Each premium is measured at the household (rather than the individual) level.

Box 1 Individual poverty premiums, by type

This table defines and categorises each premium, and summarises how each one was measured in our survey of low-income households

1. Use of prepayment meters

- **Prepayment meter, electricity:** paying by prepayment meter for household electricity
- **Prepayment meter, gas:** paying by prepayment meter for household gas
- **Best prepayment switch deal:** penalty paid by prepayment customers to reflect that their best tariff is higher than the best available tariff - measured by those who switched household fuel supplier within the last two years

2. Use of non-standard methods of bill payment (excluding prepayment meters)

- **Payment on receipt, electricity:** paying on receipt of bill (standard billing) for household electricity
- **Payment on receipt, gas:** paying on receipt of bill (standard billing) for household gas
- **Best standard billing switch deal:** the penalty paid by standard billing customers to reflect that their best tariff is higher than the best available tariff - measured by those who switched household fuel supplier within the last two years
- **Monthly payments, home insurance:** paying for home contents insurance by monthly direct debit premiums
- **Monthly payments, car insurance:** paying for car insurance by monthly direct debit premiums

3. Not switched to best fuel tariff

- **Fuel switching:** : not switching fuel supplier within the last two years

4. Paper billing

- **Paper billing, electricity:** receives paper bills for household electricity
- **Paper billing, gas:** receives paper bills for household gas
- **Paper billing, landline/broadband:** receives paper bills for landline and/or broadband
- **Paper billing, mobile:** receives paper bills for mobile phone

5. Area-based premiums

- **Shopping premium:** Finding it quite or very difficult to get to good-value stores for food and grocery shopping
- **Area premium, home contents insurance:** The additional premium for living in a more deprived / high-crime area
- **Area premium, car insurance:** The additional premium for living in a more deprived / high-crime area

6. Insurance of individual items

- **Insurance for specific items:** buying insurance for specific household items such as kitchen appliances, TV etc.
- **Insurance for mobiles:** buying specific insurance for mobile phones

7. Access to money

- **Fee-charging ATM:** Use of fee-charging cash machines in the last 12 months
- **Fee-charging cheque-cashing:** Use of fee-charging cheque-cashing in the last 12 months
- **Prepaid card:** Use of prepaid cards in the last 12 months

8. Use of higher-cost credit

- **Rent-to-own:** Use of rent-to-own stores to purchase such as BrightHouse, Perfect Home, Buy as You View in the last 12 months
- **Payday loan:** Use of payday loans in the last 12 months
- **Home collected loan:** Personal loan from company that collects payments from your home, sometimes called a 'doorstep lender' or 'home collected credit' e.g. Provident, Greenwoods in the last 12 months
- **Subprime personal loan:** Use of a personal loan from a company that does not require a good credit rating e.g. Satsuma Loans, Pounds to Pocket, Cash Converters in the last 12 months
- **Pawnbroking loan:** Use of a pawnbroking loan in the last 12 months
- **Subprime credit card:** Use of a credit card from a company that does not require a good credit rating e.g. Ocean, Luma, Vanquis in the last 12 months
- **Mail order catalogues:** Use of mail order catalogues, paid in instalments from a company that does not require a good credit rating such as Marisota, Jacamo, Fashion World, Park in the last 12 months
- **Hamper schemes:** Use of Christmas food hamper schemes, paid in instalments, such as Park, in the last 12 months

3 Experiencing the poverty premium

The focus of this chapter turns to the experience of the poverty premium among low-income households. We explore this in two key ways, first in relation to the numbers of low-income households exposed to each component of the premium, based on the findings from our survey of low-income households. Second, in relation to the prevailing issues emerging from the focus groups convened for this project. To reflect the new thematic categorisation the previous chapter has offered, we examine these in relation to:

1. Use of prepayment meters for fuel
2. Use of non-standard methods of bill payment (excluding prepayment meters)
3. Not switched to best fuel tariff
4. Paper billing
5. Area-based premiums (covering insurance and grocery shopping)
6. Insurance of individual items
7. Access to money
8. Higher-cost credit

3.1 Use of prepayment meters for fuel

The use of prepayment meters for paying for fuel has implications not only for the ongoing, everyday costs of fuel, but also in terms of the savings prepayment meter users cannot access through switching, even if they switch to the best prepayment meter deal.

Based on our survey, around a third of low-income households used prepayment meters: 32 per cent for electricity and 27 per cent for gas. Tenure was a particularly distinguishing factor, with prepayment use being most common among those living in social housing (53 per cent of Local Authority tenants and 46 per cent of Housing Association tenants used prepayment meters for both gas and electricity), compared to fewer than one in ten among owner occupiers.

Premium: Use of prepayment meters	% of low-income households
Electricity	32
Gas	27

N = 947, weighted.

The focus groups undertaken for this study highlighted how, for some households, using a prepayment meter does not happen out of choice, but because they are unable to change to a standard credit meter. Examples included participants who had moved into properties which already had a prepayment meter in place. They had either not considered changing to standard billing, or had contacted their supplier about changing, but been told that it would cost £100 to £200 to have it removed. As mentioned earlier (in chapter 2), Ofgem has been working with suppliers in recent years to end installation and removal charges and only a minority of suppliers now charge (Ofgem, 2015b); however, the pervasiveness of these charges in householders minds may represent as significant a concern as the charges themselves. Another participant wanted to change, but was in arrears so was unable to.

"The main thing that puts me off is because you need to pay to have your box took away. It's quite a lot of money just to take the box away, just £170.00 just like that."

(Female, aged 18-25, Glasgow)

While some customers have prepayment meters imposed on them, other participants expressed a preference for prepayment meters over other methods of payment. In particular, this related to the control they felt it gave them over how much energy they used and prevented them from using more than they could afford. This was a key issue raised by households with children where it was felt to be harder to monitor energy use.

"I plan my money out every single week so I know like how much money I can spend on it, so I've been staying in my house now for nearly 4 years myself and so I know every week how much to spend, and I think even now if I was to swap to pay monthly I'd be

scared in case I was running it up and I'd be like using too much gas."

(Female, aged 18-25, Glasgow)

"And while you're on key meter you're conscious to make sure everything is switched off at night, you know, you get used to it, you know what kids are like they leave things turned on."

(Male, aged 26-55, Bideford)

Prepayment meters also avoided the risk of receiving an unexpectedly large bill and therefore provided peace of mind. This perceived risk was also related to a lack of trust in energy suppliers to bill customers correctly, with many participants recounting stories of where suppliers had billed people incorrectly, including: receiving very large over-estimated bills, or finding themselves in arrears where bills had under-estimated the amount they were using. It was also related to the perceived risk of becoming unemployed and no longer being able to afford direct debits when not in work.

Preference for prepayment meters also occurred because of habit. Where people had used them for a long time they did not want to change their routine.

These findings are important because they show that being able to control expenditure on fuel can be more important than getting a cheaper price. This indicates a likely demand within the sector to devise and put in place new cost-effective methods of monitoring and paying for fuel use which do not penalise financially those who need them most.

3.2 Use of non-standard methods of bill payment

The use of non-standard methods of bill payments (other than prepayment meters which we have addressed above) relate to fuel and insurance. They are derived both by choice driven by a desire to retain control and, with that, an aversion to risk, but in relation to insurance is also imposed on households who cannot afford to pay on an annual basis.

3.2.1 Fuel

Based on our survey, only a minority of low-income households (seven per cent) paid for their electricity or gas on receipt of monthly or quarterly bills (standard billing). This was higher among

households where the main income earner was retired (eight per cent) compared to non-retired households (four per cent).

Premium: Payment on receipt of bill	% of low-income households
Electricity	7
Gas	7

N= 947, weighted.

Interestingly, use of payment on receipt was not because households were financially excluded: some 93 per cent of low-income households had a bank account with a debit card facility. The focus groups identified that the main reason they gave for paying for fuel bills on receipt was habit, reflecting something they had always done.

Nonetheless, other reasons for preferring to pay on receipt of a bill included: pay cycles that did not fit in with monthly direct debit payments; previous experience of paying by direct debit and incurring bank charges; and having built up credit on their fuel account through unknowingly over-paying. For one participant who lived in a shared house, it was because no one wanted take sole responsibility for a direct debit. Altogether, this makes initiatives which might otherwise encourage householders to switch to monthly direct debits difficult to conceive.

Notably, some participants were happy to pay *other* bills by monthly direct debit, just not fuel. In particular, the concern for fuel bills related to the uncertainty of the size of a bill, which varies depending on usage over the year (higher in winter and lower in summer), in contrast to other bills that are fixed, such as mobile phone contracts, which make payment by direct debit more predictable and manageable.

3.2.2 Insurance

We found that around a third of low-income households paid for car insurance monthly (31 per cent), similar for home contents insurance (32 per cent). This incurs a premium because paying for insurance by monthly instalment (typically by monthly direct debit) incurs a credit charge compared with paying the full amount annually upfront.

Premium: Insurance monthly payments	% of low-income households
Home contents insurance	32
Car insurance	31

N = 947, weighted.

One in ten (nine per cent) paid for both types of insurance this way, increasing to 18 per cent of households with a car. However, importantly, a poverty premium for insurance can only be incurred if insurance is taken out; and both the survey and the focus groups indicated that often low-income households avoid the costs of insurance altogether, in particular that of household contents insurance (with third-party car insurance being a legal minimum requirement). Only 52 per cent of households had household contents insurance, whereas 83 per cent of car-owning households had car insurance.⁸ Among the focus group participants paying annually upfront was unaffordable for some and paying by monthly instalment was felt to be a premium worth paying.

3.3 Not switched to best fuel tariff

There were a number of reasons why people had not switched energy supplier, which included risk aversion and a need to retain budgeting control, digital exclusion and poorer financial capability.

The results of the survey show that 73 per cent of low-income households had not switched fuel supplier in the last two years, and this was higher still among the digitally excluded (83 per cent).⁹ By payment type, eight per cent of households with a prepayment meter *had* switched, as had one per cent of households who paid by standard billing.

Premium: Not switching	% of low-income households
Have not switched energy supplier in the last two years	73

N= 947, weighted.

⁸ The remainder may reflect cars owned by someone other than a household member and some degree of measurement error.

⁹ For the purposes of this report, the digitally excluded are defined as those who had not used the internet in the last three months to search for or buy any products or services.

The reasons why low-income households in our focus groups had not switched were varied. Overall, they were risk averse to changing and would rather stay with the current supplier that they knew and trusted to deliver them a good service without billing problems. Many were also sceptical about good deals: either that they wouldn't be better, or that the price would soon go up again. For some this mistrust arose from personal experience.

"With me it's a case of better the devil you know than the devil you don't."

(Male, aged 26-55, Bideford)

Even though some participants had the internet and used price comparison sites for buying other products such as insurance, they had not considered doing the same for fuel. The complexity of the energy market was a barrier and for some people on prepayment meters there was a lack of awareness that it was possible to get a cheaper deal.

"You're comparing prices that you don't even really know what they mean, that's the problem."

(Male, age 26-55, Glasgow)

"I just thought that you had to be paying it monthly to get deals and that, I thought with prepaid it was just what you put in and that's it."

(Female, age 18-25, Glasgow)

Among those that had switched this was often the result of being 'cold-called' or approached by an energy supplier representative on the street offering them a better deal, or by talking to family and friends.¹⁰ Only a very few households who paid for their fuel by prepayment meter or on receipt of a bill had switched in the last two years. As discussed in Chapter 2, this incurs a premium because customers who pay by these methods are unable to get the cheapest deals that are available to those who pay by monthly direct debit.

¹⁰ Following publicity about energy supplier mis-selling, Ofgem introduced tougher rules on doorstep sales in October 2009 requiring suppliers to provide customers with written estimates before any sales are concluded. A new requirement that any information used in marketing activities is clear, accurate and easy to understand was also applied to cover telesales.

Premium: Switching	% of low-income households
Switched - on best prepayment meter tariff	8
Switched - on best standard billing tariff	1

N= 947, weighted.

3.4 Paper billing

Overall, a quarter of low-income households received paper bills for their gas (24 per cent) and electricity (26 per cent), although not all of these will have been with providers that offered a discount for online billing. Households in which the main earner was retired were more likely to receive paper bills (38 per cent for electricity and 32 per cent gas). Similarly 28 per cent of low-income households received paper bills for their landline and/or broadband, although this falls away to 13 per cent for mobile phones.

Premium: Receipt of paper bills	% of low-income households
Electricity	26
Gas	24
Landline/broadband	28
Mobile phone	13

N= 947, weighted.

The main reasons why some focus group participants preferred to receive paper bills were: a lack of confidence and skills in using the internet; and preferring paper bills to keep a record of their bills in 'black and white', fearing that an emailed bill notification could be easily missed or forgotten about. Participants in the two older focus groups (aged 65+) were particularly averse to using the internet for *paying* bills because of a lack of trust in internet security and the perceived risk of having their bank account hacked.

"I don't trust anything to do with banking or paying money on the computer."

(Male, aged 65+, Telford)

Meanwhile, some participants were not aware that online billing was an option.

3.5 Area-based premiums

Area-based premiums relate to higher premiums for insurance and a lack of access to good value shops. They derive largely from structural supply factors outside the household's control.

3.5.1 Insurance

Low-income households living in deprived areas can do little to avoid an area-based premium if they take out home contents or car insurance. As we saw above, only 52 per cent of households had household contents insurance, although 83 per cent of car-owning households reported having car insurance.

Premium	% of low-income households
Home contents insurance	52
Car insurance	52

N= 947, weighted.

The seemingly low penetration of home contents insurance is most likely to reflect that home contents policies (or at least households' perceptions of them) are not suitable for the lowest income households. Indeed, focus groups participants noted that it wasn't always worth taking out home contents insurance as the minimum sums insured are often far higher than low-income households need.

"I've not really got anything worth anything."

(Female, aged 26-55, Glasgow).

As such, exposure to insurance-related poverty premiums arguably reveals a different kind of poverty than that which comes from exposure to fuel poverty premiums: it is a premium that comes from struggling to participate in consumer society rather than from being excluded from it. The consequence of not having contents insurance

was also evident in the focus groups. A few participants had previously been burgled and were unable to replace the goods that were stolen. For one unfortunate household, this occurred just before Christmas:

“When I’ve got good stuff again, I will look into it, but I’m job seekers allowance at the moment.”

(Male, aged 26-55, Telford)

For car insurance, the picture is likely to be much more straightforward. Households have it when they need it or else face high penalties if they are caught driving uninsured.

3.5.2 Shopping for food and groceries

As we have conceived it, the shopping premium arises because of a combination of where low-income households live and their more limited access to private transport, which can make more competitively priced stores harder to reach.

Overall, only 14 per cent of low-income households incurred this premium. However, households without a car were significantly more likely to find getting to good value shops either fairly or very difficult (21 per cent). Conversely, whether households lived in urban, suburban or rural areas made little difference.

Premium:	% of low-income households
Difficulty accessing good value shops for food and groceries	14

N= 947, weighted.

This reflected the picture described by the focus group participants who, on the whole, did have a wide range of good value shops to choose from.

“If you've got the means to travel you can always get the cheaper stuff.”

(Female, age 26-55, Telford)

Conversely, those without cars got to the shops they used by bus, taxi, on foot, or by getting lifts with friends and family. It was noted by some of them that getting to shops without a car could be time consuming, inconvenient and expensive.

"After 2 o' clock the Asda bus only runs every hour and that's a bit of a nuisance you know."

(Female, aged 65+, Bideford)

"I walk up the back road to Asda, it takes me about 35 minutes. If I get a taxi it's £8 for that time in the morning [2am], so then I just get a taxi back."

(Male, aged 26-55, Telford)

Although it did not emerge from our focus groups, relying on public transport or walking also reduces people's ability to capitalise on cheap bulk-buying deals, although this may already be limited by the inability to afford to buy in bulk.

3.6 Insurance of individual items

Insurance of individual items encompasses policies for white goods and other household appliances and mobile phones. Household appliance insurance was held by 13 per cent of the households. A similar number held mobile phone insurance (16 per cent).

Premium: Individual item insurance	% of low-income households
Household appliance insurance	13
Mobile phone insurance	16

N = 947, weighted.

Notably, the survey found that more than twice as many households with household appliance insurance *also* had home contents insurance, than didn't. Overall, 16 per cent of low-income households were apparently over-insured, holding both home contents and some other form of individual-item insurance. It is likely that this reflects a risk aversion among these households, although it might also indicate that they have been 'sold' insurances which they do not need.

Participants in the focus groups who held policies for individual items generally believed they were worth having. This was either due to the need to replace a lost or broken mobile phone frequently or because the item was considered vital to their household that they could not afford to be without.

“You only buy a washing machine when it breaks, it would then take me about 6 months to have £200”.

(Female, aged 26-55, Bideford)

However, even those participants with mobile phone insurance expressed mixed feelings about holding such insurance, because they expected any claim to be rejected on the basis of a policy exclusion.

3.7 Access to money

Our review of the poverty premium identified three components related to access to money: the use of fee-charging cash machines; the use of fee-charging cheque-cashing; and the use of prepaid cards as an alternative to a debit or credit card.

The numbers of households exposed to them varied considerably: some 27 per cent of low-income households had used fee-charging cash machines at some point in the last year, compared with only four per cent who had used fee-charging cheque-cashing services, and three per cent who had used prepaid cards. Only four per cent had incurred two types of access to money premiums, and these were likely to be in households in which the main earner was of working age ('working-age households').

Premium: accessing money	% of low-income households incurring premium
Fee-charging cash machines	27
Fee-charging cheque-cashing	4
Prepaid cards	3

N= 947, weighted.

However, strong indications from the focus group participants were that *needing* to pay to access cash from cash machines is becoming more uncommon; few felt it was difficult to find free cash machines, even if this involved going slightly out of their way. Moreover, the ease with which it is possible to pay by card means that there is less need to have cash to pay for low priced goods. Even in more rural

locations, most of our participants could access money for no charge.¹¹

Size of household appeared to be an important factor according to our survey, at least in relation to using fee-charging cash machines. In particular, lone parents and single adults were less likely to have paid to withdraw cash (10 per cent and 19 per cent respectively) whereas households comprising of two adults were much more likely to have done so (35 per cent). Working-age households and those who rented from a private landlord were the most likely to have to paid to withdraw cash. This would tend to support the findings of the focus groups that households which are better able to afford the small fees associated with accessing cash in this way are perhaps more likely to choose do so.

3.8 Higher-cost credit

As chapter 2 identified, the use of higher-cost credit is driven largely by financial exclusion, lack of affordability, low usage and a desire for close budgeting control. Poor access to affordable credit and a lack of suitable credit that meets the needs of lower-income households' reflects where structural, or supply-side factors interact with demand-side factors.

The number of households who had used each of the different types of higher-cost credit was small. Reflecting findings from previous research,¹² households were highly unlikely to use pawnbrokers (less than one per cent) or payday loans or subprime loans (one per cent), while the use of higher-cost mail order catalogues was somewhat higher, at six per cent.

Overall, just over one in six low-income households had used higher-cost credit across any of these types (16 per cent). Most had used only type (11 per cent overall). Three per cent had used two different types of higher-cost credit, and only one per cent had used it more than this. Those most likely to have used higher-cost credit at all were households consisting of two adults (33 per cent), and in particular, those who are financially excluded,¹³ where nearly half (46 per cent)

¹¹ Though, by their very nature, focus group participants are likely to be more financially included and mobile.

¹² E.g. analysis of the 2006-08 Wealth and Assets Survey showed that only one per cent of all adults in Great Britain had any form of high cost credit from the three types captured in the survey (less than one per cent for pawnbroking or payday loans and one per cent had home collected loans; PFRS, 2013).

¹³ Treat with caution due to low base size (of 42 cases in the sample).

had used higher-cost credit in the last year. Those not in working age households were least likely to have done so (nine per cent).

Premium: Use of higher-cost credit	% of low-income households
Rent-to-own	2
Payday loans	1
Home collected loan	3
Pawnbroking loan	<1
Subprime personal loan	1
Subprime credit card	4
Mail order catalogue	6
Christmas hamper scheme	3

N= 947, weighted.

While some of our focus group participants described having used various forms of higher-cost credit in the past, or were currently using it, it was more typical for people to report avoiding using credit in any form at all. One of the key ways in which this premium was avoided was by buying goods second hand; Gumtree, eBay and local Facebook selling pages were mentioned as places to buy goods from, or sometimes to acquire them for free.

“When I first moved into my house, I was struggling a little bit... I went on Gumtree and a guy was giving away a two-seater and a three-seater couch and that, if you come and get it, so I just paid a guy in a van to go and get it and I got the sofas for nothing, just gave it a good clean and it was immaculate”

(Male, Glasgow, aged 18-25)

There was nonetheless a limit to what households were prepared to buy second hand. For example, some were reluctant to buy electrical goods second hand, stating the potential unreliability as a reason, and most were averse to replacing items such as mattresses second hand.

Even when purchasing new, however, it was possible for many to avoid using higher-cost credit; many used interest-free credit, or mainstream credit provided in-store, for example in Argos, or DFS furniture store. This was, however, dependent on a reasonable credit rating, and some in the focus group respondents admitted that they were not able to access mainstream credit.

Finally, going without, and not replacing goods unless absolutely necessary was a strategy also employed to avoid the use of credit and indeed any non-essential spending.

“When my washing machine has broken down in the past, I’ve stood at the sink and washed [my laundry] by hand.”

(Female, Bideford, aged 26-55)

This does highlight one of the fundamental characteristics of the poverty premium, in that it is an opportunity cost. We have not attempted to calculate the cost associated with this.

Where people did report using higher-cost credit, the value of BrightHouse in enabling people to replace an item in an emergency was prominent.

“I can't just go to Argos and say I want that, I just can't. So I have to go for these weekly... I have to do BrightHouse... the kids have to starve if anything like the oven breaks.”

(Female, Telford, aged 26-55)

From our survey, Christmas was the single most common reason why households had used higher-cost credit, with over one fifth (21 per cent) of the borrowing being used for this purpose, followed by general day to day spending at 16 per cent. Overall, 16 per cent had borrowed to purchase white goods (seven per cent washing machine, four per cent cooker and five per cent fridge), 15 per cent for electrical goods (seven per cent TV and eight per cent other electrical items) and eight per cent overall had borrowed for furniture. In comparison, borrowing for more discretionary items was much less common; six per cent borrowed for a holiday and six per cent borrowed for clothes.

While Christmas was the single most common reason why low-income households had used higher-cost credit, this was still comparatively unusual. The focus groups identified that, as far as possible, most people planned for Christmas expenditure and spread the cost by buying presents early or paid into formal informal savings

schemes. Buying clothes from catalogues was generally used as a budgeting tool. Typically, it was those who felt they had no other options, in terms of either paying cash or accessing mainstream credit, who ultimately paid a poverty premium though using higher-cost credit.

4 Counting the cost of the poverty premium

A particular, unique objective of this study was to estimate the number of low-income households affected by the poverty premium: the prevalence of the experience of the premium, overall and by its components. As described in Chapter 3, we have found that the proportion of households exposed to each premium varied. A further objective of this study was to calculate the overall average cost of the poverty premium. To do this we have undertaken a detailed costing process of assigning a nominal value, in pounds and pence, to each premium.

The costs we have allocated are based on a set of underlying assumptions and, where appropriate, available market data. They range from £9 per year for the cost associated with paying home insurance by monthly instalment to £317 for the cost of not being on best fuel tariff. Full details of how we arrived at each cost, including our assumptions, are provided in the Costing Appendix. By applying each level of exposure to its nominal cost, we quantify the average poverty premium incurred across all low-income households. In other words, where only 14 per cent of households experienced a shopping premium for example, we multiplied the nominal cost of £266 for this component by 0.14 (14 divided by 100 to convert from percentages to proportions).¹⁴

Looking across all 29 cost elements, this chapter considers where the biggest premiums lie, taking into account both the percentage of households exposed and the nominal costs. We complete the analysis by making some assessments of the financial impact of the premium on households' standards of living by comparing (by broad household composition) the total premium to standardised income thresholds. The analysis is fully replicable for future measurement of the premium.

¹⁴ In practice, these calculations were undertaken to several decimal places for greater accuracy.

4.1 The total average poverty premium incurred by households

Summing together the average premium incurred by low-income households for each of the individual components, the overall average cost of the poverty premium is estimated to be **£490** per year per household (see Appendix Table 4A, at the end of this chapter).

This is lower than previous estimates of around £1,300 per year (Save the Children, 2010) and can be explained by three factors. Most crucially, it derives from the ways that the premium was calculated. Our calculation of the average premium for each component involves an adjustment to take into account the proportion of households incurring it. In other words, it doesn't assume all low-income households incurred all premiums. This therefore produces an average premium that is actually incurred rather than the highest possible – hypothetical – poverty premium that could be incurred.

In addition, there are differences in the assumptions underpinning the cost calculations. For example, in the number of times a product or service was used within the 12 month reference period, and in the inclusion of baseline costs against which the costs incurred by low-income households are compared.¹⁵

But there are other contributory factors too. For example there have been advances in industry regulation and practice – such as a reduction in tariffs for prepayment meter fuel customers and caps on the total cost of lending for payday loans. New entrant, low-cost supermarkets have opened stores in or near low-income neighbourhoods. And we have seen continued improvements in digital inclusion.

4.2 The largest contributors to the poverty premium

The contribution of each component to the overall poverty premium derives from both its incidence and the size of the calculated cost of the premium. As such, that contribution varies greatly.

For example, some 73 per cent of low-income households had failed to switch supplier in the last two years and this was coupled with a large calculated cost per year, of £317. However, while some 52 per

¹⁵ Baseline costs are the nominal costs we have allocated to each area of the poverty premium that we have assumed are paid by non-poor households who do not pay any premium. For example, we assume that non-poor households do not pay to access cash and pay for their fuel by monthly direct debit.

cent of households had incurred an area-based premium for home contents insurance, this was associated with a much smaller, nominal cost of £14 per year. In contrast, home collected loans and subprime personal loans were associated with a calculated cost of £540 and £520 respectively, but only three per cent and one per cent of low-income households reported having used these.

In other words, some components are problematic for low-income households because a large number of them incur a poverty premium, however small (they are broad). Others are problematic because a small minority incur a very large premium (they are deep). And others still, such not being on the best fuel tariff, are problematic because large costs are incurred by large numbers of low-income households (they are both broad and deep).

4.2.1 The poverty premium by type of premium

Using our categorisation of the underlying causes of the poverty premium (discussed in Chapter 2), Table 1 shows the relative contribution of each category to the overall poverty premium. The largest share of the average poverty premium experienced by households by far – at £233 per year – is accounted for by not switching fuel supplier (column 2, Table 1). This represents £48 in every £100 (almost half) of the poverty premium incurred by households (column 3, Table 1). The next largest share, at £84 per year, is made up of area-based premiums: this is largely accounted for by premiums related to car insurance and difficulties accessing good value shops. Together, area-based premiums contribute around £17 for every £100 of the poverty premium incurred by households.

Higher-cost credit, at £55 per year, makes up a further £11 in every £100 of the premium, followed by use of prepayment meters contributing £8 in every £100 (£38 per year), a preference for non-standard billing methods accounting for a further £7 in every £100 (£33 per year), and insurance for individual items representing £6 in every £100 (£27 per year). Finally, paper billing (£12) and access to money (£9) contribute the least to the overall poverty premium at just £2 in every £100 (Table 1).

Table 1 Share of the premium annual poverty premium cost by premium type

Premium type	Low-income households incurring this %	Average premium per low-income household £ / year	Average premium as a share of the total %
Use of prepayment meters	33	38	8
Non-standard billing methods	50	33	7
Not switched to best fuel tariff	73	233	48
Paper billing	49	12	2
Area-based premiums	73	84	17
Insurance for specific items	23	27	6
Access to money	29	9	2
Higher-cost credit	16	55	11
Total	99	490	100

Source: Survey, n= 947, weighted. Note. Figures may not sum correctly, due to rounding.

Looked at another way, we find that the largest share of the poverty premium is accounted for by components which relate to fuel, equivalent to 57 per cent; or £57 in every £100. This amounts to a calculated £279 per year per low-income household. Some 86 per cent of low-income households were exposed to at least one fuel-related premium.¹⁶ The next largest share is accounted for by expenditure on insurance, which contributes 20 per cent (or £99 per year) to the total premium incurred on average across households. Some 71 per cent of households incurred one or more insurance premiums. In other words, most low-income households incur a fuel or insurance premium in some form. Notably, meanwhile household fuel and car insurance in particular comprise some of the least avoidable costs.

Appendix Table 4A, at the end of this chapter, shows in detail how the premium is constituted. It shows the breadth of exposure to a premium (the percentage who incur it, shown in the first column), the depth of the premium when incurred (the assumed cost of the premium per year, in the second column), and the average cost of the premium per household taking into account the proportion

¹⁶ This includes paper billing for electricity and gas.

experiencing it (in column 3). As such, and looking across the different types of premiums, we can see that fuel makes up the largest share of the premium not only because several cost elements (nine in total) relate to fuel, but because these cost elements also tend to be high (i.e. more expensive), or experienced by large numbers of households, or both.

Indeed the relative importance of the components of the poverty premium varies greatly depending on their incidence and the size of the calculated cost. In summary, we find in particular that:

- Premiums for those experiencing them are highest for higher-cost credit but the numbers affected are relatively small (Table 1). While this means that the impact on all low-income households is relatively modest, for those which it does affect it can be significant. This is true to a lesser degree with shopping for food and groceries.
- Incidence is highest for fuel and insurance (Appendix Table 4A). One conclusion from this is that most low-income people face at least some penalty in these areas, so the impact is broad if not always deep. Because there is one fuel component, failure to switch, which is both common and costly, the average impact in the case of fuel is greater than for all other areas combined.
- Incidence is for non-standard billing methods and receipt of paper bills is also high (Table 1), but the premiums associated paper billing in particular are low, which means the impact of incurring paper billing premiums, in isolation at least, is minimal for those affected *and* across low-income households as a whole.

We draw out the influence of the individual components of the premium further below.

4.2.2 Individual components of the poverty premium

Appendix Table 4A confirms that, taking into account the percentages of households incurring an individual premium component and the cost allocated to each one, the largest single premium overall arises because, regardless of payment method, low-income households have not switched to the best fuel deals (£233). So large is this that it is some six times higher than the next largest incurred by low-income households – the shopping premium at £38. The average poverty premium paid across low-income households for the area-based car insurance was also £38, which, when added to the premium for paying car insurance by monthly instalment (£25), is substantial (at a combined cost of £63).

Other components which contributed more than £10 to the average cost of the premium across households were: being on a fuel prepayment meter despite having switched (£18) – added to the use of prepayment meters for gas (£11); using home collected loans (£17); buying household appliance insurance (£17) and using mail order catalogues (£11).

Individual components contributing the least to the overall premium were the use of prepaid cards, fee-charging cheque-cashing, paper billing for electricity and for gas, each contributing £1 to the average household's poverty premium, and pawnbroking loans and switching payment on receipt fuel supplier, each of which contribute less than £1.

That said, for prepayment meter users who had switched supplier, they still incurred an expensive premium of £227 per year, which reflects that even by switching, prepayment meter users cannot access deals equivalent to those offered to customers who pay by monthly direct debit with online account management. Its relatively small contribution to the poverty premium overall reflects that only eight per cent of low-income households were exposed to it.

And, overall, the calculated costs of individual premiums are highest for higher-cost credit. The single most expensive premiums a household could incur are for the use of home collected (doorstep) loans (£540 per year) and subprime loans (£520 per year). The use of rent-to-own stores, for example to buy white goods, was calculated at £315 per year. However, because the numbers affected are relatively small, higher-cost credit makes up only a relatively small share of the estimated total premium. This again highlights that while the average impact across all low-income households is relatively modest, for those which it does affect it can be significant.

4.3 Impact on living standards

To put the findings in context, we have looked at the weekly average cost of the poverty premium (calculated according to household type from the survey data) against the typical median income for the households. The overall annual average of £490 is approximately £9 per week among low-income households on average. We have first calculated the equivalent weekly figure, by broad household size. This is based on applying the actual percentages of low-income households incurring each component for each household type to the

overall, calculated cost of the component.¹⁷ And second, we have compared the resulting figures to the thresholds for 70 per cent and 60 per cent median income (Table 2).¹⁸ Due to the underlying assumptions made in the calculation of the nominal costs and the different timeframes for the different data sources used, the resulting figures and comparisons should, at best, however, be seen as *indicative*.

As can be seen from Table 2, the premium apparently hits hardest in single adult households followed closely by lone parents. Although single adults incur the lowest poverty premium cost, their lower household income means that they are most affected. A single person with an income at 70 per cent of the median would need almost three weeks' additional income a year just to cover the cost of the poverty premium. If their income was lower still (at the 60 per cent level) they would need over three weeks' extra income.

In contrast, a couple with two children are least affected: they incur a lower poverty premium than other households with children and they have higher incomes. They would need just over one week's extra income if their income was 70 per cent of the median and one and a half weeks if it was at the 60 per cent level. For a couple household without children (which is the 'baseline' household type of income comparisons), the equivalent figure is one week and five days of the income required to meet a minimum income standard for, or 3.3 per cent.¹⁹

¹⁷ Note that, importantly, this does not adjust for household size within the original calculation of the nominal costs for the individual components so is at best only *indicative*.

¹⁸ Median income is equivalised (to take into account household size) and is based on 2014/15 figures from DWP (2016) *Households below average income: an analysis of the income distribution 1994/95 to 2014/15*. London: Department for Work and Pensions. It is rounded to whole £s.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/532416/households-below-average-income-1994-1995-2014-2015.pdf

¹⁹ Calculated for 2016 as £330 per week (Davis et al, 2016).

Table 2 Comparison of the poverty premium by household type against income thresholds

	Annual (weekly) poverty premium	70% median weekly income	Premium relative to 70% median income	60% median weekly income	Premium relative to 60% median income
Single adult	£465 (£9)	£164	5.5% 2 weeks and 6 days	£141	6.3% 3 weeks and 2 days
Lone parent, one child	£542 (£10)	£221	4.7% 2 and a half weeks	£189	5.5% 2 weeks and 6 days
Couple with no children	£560 (£11)	£283	3.8% 2 weeks	£242	4.4% 2 weeks and 2 days
<i>Couple, two children</i>	<i>£504.44 (£10)</i>	<i>£396</i>	<i>2.5% 1 week and 2 days</i>	<i>£339</i>	<i>2.9% 1 and a half weeks</i>

Source: DWP (2016) and Oak Survey, n= 947, weighted. Calculations were made prior to rounding.

These additional costs occur in the context of already low-incomes, often with high demands placed on them. The cost of the poverty premium in a lone parent family could provide the children with the clothes and shoes they need for a whole year. It could enable an individual or a family to put money into savings which could help them avoid some of the costs associated with the need to borrow using higher-cost credit.

The next chapter, therefore, explores how the components of the premium combine to produce different patterns of poverty premium, and explores which low-income households are most likely to experience which combinations.

Appendix Table 4A Average annual poverty premium, by individual and type of premium

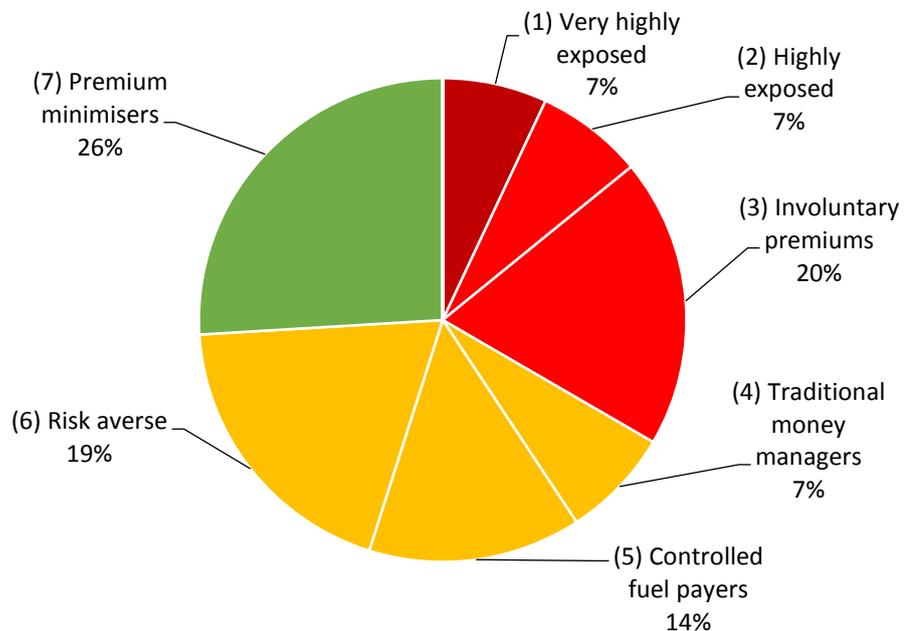
Premium	Households incurring premium %	Cost of poverty premium £ / year	Average poverty premium £ / year
Any	99	-	£490
Use of prepayment meters	33	-	£38
Prepayment meter - electricity	32	£35	£11
Prepayment meter - gas	27	£35	£9
On best prepayment meter tariff	8	£227	£18
Non-standard billing methods	50	-	£33
Payment on receipt of bill - electricity	7	£38	£3
Payment on receipt of bill - gas	7	£38	£3
On best payment on receipt of bill tariff	1	£43	£<1
Home contents - monthly payments	32	£9	£3
Car insurance - monthly payments	31	£81	£25
Not switched to best fuel tariff	73	£317	£233
Paper billing	49	-	£12
Paper billing - electricity	26	£5	£1
Paper billing - gas	24	£5	£1
Paper billing - landline/ broadband	28	£23	£6
Paper billing - mobile	13	£23	£3
Area-based premiums	73	-	£83
Home contents insurance - deprived area	52	£14	£7
Car insurance - deprived area	52	£74	£38
Difficulty accessing good value shops	14	£266	£38
Insurance for individual items	23	-	£27
Household appliance insurance	13	£132	£17
Mobile phone insurance	16	£60	£10
Access to money	29	-	£9
Fee-charging ATM	27	£25	£7
Fee-charging cheque-cashing	4	£30	£1
Pre-paid card fees	3	£25	£1
Higher-cost credit	16	-	£55
Rent-to-own	2	£315	£7
Payday loan	1	£120	£2
Home collected loan	3	£540	£17
Pawnbroking loan	<1	£50	£<1
Subprime personal loan	1	£520	£7
Subprime credit card	4	£194	£9
Mail order catalogues	6	£178	£11
Christmas hamper scheme	3	47	1

Source: Survey, n= 947, weighted.

5 Patterns of exposure to the poverty premium

Cluster analysis is a statistical approach to segmenting a population based on characteristics of interest. In the context of the exposure to the poverty premium, these characteristics are the 29 individual premiums discussed above.²⁰ This section describes the results of a cluster analysis from which emerged seven distinct clusters of individuals representing the most dominant patterns, or combinations, of poverty premiums low-income households experienced in 2016. The segments are described and interpreted based on their relative exposure to the premiums. This is extended in an analysis of the relative composition of each segment by key socio-demographic and economic factors, to understand the types of people who comprise the larger share of each cluster. Illustrated in Figure 3, the chart shows how we have labelled the clusters based on the nature of their exposure to the premiums.

Figure 3: Seven clusters of exposure to the poverty premium



Source: Survey, n= 947, weighted.

²⁰ In fact, the cluster analysis used 26 premiums, although the resulting analysis of the clusters describes the 28 premiums. The precise methodology we have used to undertake the cluster analysis is described in the Methodological Appendix - see for more information.

5.1 Interpreting the clusters

The clusters have been interpreted in relation to their exposure to these premiums compared with the average and where their exposure is so high, relative to other groups, that it distinguishes them. The average cost of each premium, by cluster is shown in Appendix Table 5A. The proportions incurring each premium by cluster, which underpin these costs, are shown in Appendix Table 5B.

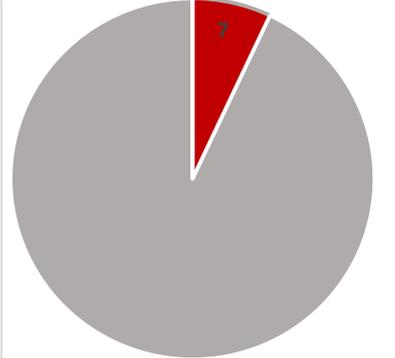
Cluster membership is also described by the socio-demographic and other characteristics of households in poverty (Appendix Table 5C). Cluster membership was not strongly determined by socio-demographic and other characteristics and several clusters represented cross-sections from across the populations of low-income households.

5.1.1 Cluster 1 profile: Very highly exposed

Cluster 1 comprises a small group of households (seven per cent of low-income households). They incurred an average of eight premiums across five categories, and for eight of the individual premiums, they were the most likely of all the clusters to incur them. The average poverty premium they incur annually is estimated to be in the region of **£750**.²¹ This is about 1.5 times the average premiums incurred across our clusters, and the highest average cost overall. These are the most exposed households to the poverty premium, both in terms of breadth and depth of premium.

In particular, households in this cluster were defined by their use of prepayment meters (all had a prepayment meter for electricity, gas or both) and insurance-related poverty premiums, plus nearly four in ten (39 per cent) had used higher-cost credit. These households therefore incurred the highest average poverty premium in relation to the use of prepayment meters (£184), higher-cost credit (£155), individual item insurance (£69) and access to money (£19). Area-based premiums (£95), were also high, in large part due to car insurance, and insurance-related premiums altogether accounted for £207, more than a quarter of this cluster's total premium and the most of all the clusters.

²¹ As with the overall premium, when totalling the cost elements members of the clusters are exposed to, we have adjusted for the proportion experiencing them. All totals are rounded to the nearest £10.

Cluster 1 dashboard: "Very highly exposed"	
Seven per cent of low-income households	
<p>Premium</p> <p>£750 p.a.</p> <p>Eight premiums on average</p> <p>Defined by: prepayment meter use, higher-cost credit and insurance-related premiums</p>	<p>Manual worker households</p> <p>in their family years, tenants, and internet active</p>
	
<p style="text-align: center;">Poverty premium profile</p> <p style="text-align: center;">Cluster membership (%) compared with ('v.') the average (%)</p> <p>Above average risk of incurring 18 of the premiums, including the highest risk for 8.</p> <p>Main components of the premium relative to others:</p> <ul style="list-style-type: none"> • Use of pre-payment meters: £184 v. £38 • Insurance, especially car: £207 v. £99 • High-cost credit use: £155 v. £55 	<p style="text-align: center;">Socio-demographic profile</p> <p>Key distinguishing household characteristics:</p> <ul style="list-style-type: none"> • Aged 25-59 (81% v. 57%) • Chief income earner in work (73% v. 50%) • Two or more adults in the household (82% v. 54%) • Rent their home (84% v. 61%) • Drawn from social grades C2DE (76% v. 66%) • Car owners (80% v. 60%) • Are internet purchasers (73% v. 54%)

They were the most over-represented on the use of rent-to-own, hamper schemes, home-collected loans, subprime personal loans and mail-order catalogues premiums and prepaid cards, while they carried more than twice the average risk of use of fee-charging cheque-cashing and pawnbroking loans (though the penetration of the latter nonetheless remains very low; Table A2).

Notably, some 38 per cent of households in this cluster had switched fuel provider within the last year, compared with only 17 per cent of overall. This may have been driven by extreme necessity. Still, they incurred an average premium of £118 for having switched only within (or to) prepayment meters. Another 38 per cent had never switched and it is possible that some of the households had had no option to switch fuel provider

These households were a reasonably distinct group in terms of their other characteristics. They were skewed towards people aged in their middle years (25-59), in middle (C2) or manual (DE) social grades, whose household's chief earner was in work. They largely comprised households with two or more adults (82 per cent), living in rented homes, with access to a car or van in the household. They were slightly more likely than the average to live in more suburban areas of

the country. They were also at the high end of the range in terms of their digital inclusion, with 73 per cent of these households using the internet to buy products (compared with an overall average of 54 per cent).

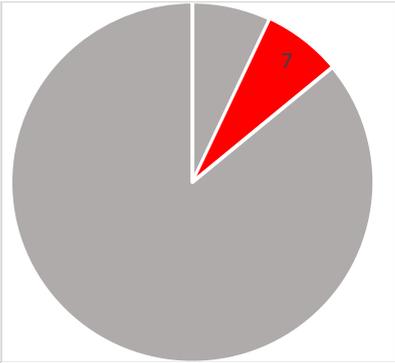
Pen portrait:²² Cluster 1 ‘Very highly exposed’

Jen is 39. She lives with her partner and daughter in a flat rented from a housing authority and, as the chief earner in her household, works full-time. Her family was exposed to several premiums, from across the types. They used **pre-payment meters** for electricity and gas and received a **paper bill** for their landline and broadband. Perhaps as a result of her use of the internet to compare and purchase goods and services, she had **switched fuel provider** in the last 12 months; even so this would have left her paying a significant amount more for fuel than her counterparts who paid by on receipt of their bills and, especially, those who paid by direct debit. Notably, they paid for home contents insurance and car **insurance** monthly, rather than all at once, while one or more mobile phone was covered by a separate policy. Despite her digital inclusion, the extent to which Jen’s household was stretched – perhaps compounded by financial exclusion – was evidenced by the use of several forms of **higher-cost credit** in the past 12 months: rent-to-own, home collected loans, subprime credit cards and mail order catalogues. All-tolled, based on these premiums alone, Jen’s family is expected to have incurred a premium of around **£1,860** in the last year. This represents a significant drain on a total annual household income of only **£16,500**.

5.1.2 Cluster 2 profile: Highly exposed

Another small group incurring an average of eight premiums, **Cluster 2** nonetheless contrasts with cluster 1 in relation to the types of premium it was exposed to. This cluster is estimated to incur a poverty premium annually of around £560. We would consider this small group of low-income households **highly exposed**. Their key characteristics are shown below, in the cluster 1 dashboard.

²² A pen portrait is a useful means of illustrating the quantitative data. Further details can be found in the Methodological Appendix.

Cluster 2 dashboard: "Highly exposed"	
Seven per cent of low-income households	
<p>Premium £560 p.a. Eight premiums on average</p> <p>Defined by area-based, higher-cost credit and paper billing premiums</p>	<p>Families with children Living in urban areas</p>
	
Poverty premium profile	Socio-demographic profile
<p style="text-align: center;">Cluster membership (%) compared with ('v.') the average (%)</p> <p>Above average risk of incurring 12 of the premiums, including the highest risk for 3.</p> <p>Main components of the additional total premium relative to others:</p> <ul style="list-style-type: none"> • Area-based (especially shopping): £118 v. £83 • Paper billing: £43 v. £12 • Higher-cost credit: £72 v. £54 • Access to money: £14 v. £9 	<p>Key distinguishing household characteristics:</p> <ul style="list-style-type: none"> • Families with children and lone parents in particular (57% v. 44%) • Aged 25-59 (65% v. 57%) • Internet purchasers (64% v. 54%) • Live in a non-metropolitan urban area (53% v. 32%)

Relative to other groups, the premium profile of cluster 2 was defined by area-based (£118), and disproportionately shopping premiums within this (£59), paper billing premiums (£43) and to a lesser extent higher-cost credit (£72) and access to money (£14). Reflecting the large contribution it makes to the total premium across all households, the largest single share of cluster 2's premium however was from not switching fuel supply (£212), although this is small than the average.

Although the paper billing premiums for this cluster were driven largely by telecoms, these households also carried more than twice the average risk of paper billing for electricity and use of fee-charging cheque-cashing, and a heightened risk of fee-charging ATM use.

The dashboard also shows that 'highly exposed' cluster membership was not particularly well defined by the characteristics of the respondent or their household; instead they represented a fairly broad cross-section of low-income households. They were, nonetheless, disproportionately highly comprised of households with children, higher social grades (AB) and those living in homes owned with a mortgage in urban areas. They were also more likely than the average to use the internet for making purchases (fully digitally

included, by our definition), and twice as likely as the average to be without mains gas.

5.1.3 Cluster 3 profile: Highly exposed: involuntary premiums

This large group, one fifth of low-income households, was exposed to an average of five premiums across three types. Compared with other groups, members of Cluster 3 were defined by prepayment meter premiums (£106; the second highest of all clusters) and, like the first two clusters, a higher than average higher-cost credit premium (£69), made up largely of home collected loans (£35). They also incurred a slightly higher than average premium for not switching fuel supplier (£264), overall making up by far the largest share (50 per cent) of this clusters total premium: **£530**, around 10 per cent higher than the average for all households. Their likelihood of exposure to the premiums was higher than the average for other households for six of the premiums, and for two of these (prepayment meter for gas and electricity), they were (joint) most likely of all the clusters to incur them.

Cluster 3 dashboard: - “Highly exposed: involuntary premiums”	
One in five of low-income households	
<p>Premium £530 p.a. Total premium high in relation to means Five premiums on average</p> <p>Defined by prepayment meter and higher-cost credit premiums</p>	<p>Low-income social renters in their middle years in the lowest social grades and out of work</p>
<p>Poverty premium profile Cluster membership (%) compared with ('v.') the average (%)</p> <p>Above average risk of incurring 6 of the premiums, including the highest risk for 2.</p> <p>Main components of the additional total premium relative to others:</p> <ul style="list-style-type: none"> • Use of prepayment meters: £106 v. £38 • Higher-cost credit use: £69 v. £55 • Not switching fuel supplier: £264 v. 233 	<p>Socio-demographic profile Key distinguishing household characteristics:</p> <ul style="list-style-type: none"> • Tenants (93% v. 61%) and social tenants in particular (61% v. 31%) • Drawn from social grades DE (74% v. 41%) • Chief income earner out of work (47% v. 25%) • Incomes below £11,500 (66% v. 54%) • Aged 25-59 (73% v. 57%)

Of all the clusters, cluster 3 is perhaps the most distinct in relation to their socio-demographic and other characteristics. In particular, these

households were highly likely to be drawn from the lowest social grades (DE; 74 per cent) and social tenants (61 per cent) and nearly a half had a chief earner who was out of work (47 per cent). This speaks to the relative poverty of this group, even among a population of low-income households, and an average premium of £530 per year is likely to be very high relative to their means (incomes). Therefore, we have classed these as **highly exposed**. They were also somewhat more likely than average to be represented by respondents in their middle, family-rearing years (ages 25-59).

Moreover, the typical housing tenure of this cluster may drive their universal (100 per cent) use of prepayment meters and higher than average on not switching fuel supplier (83 per cent). They were also the most over-represented cluster in the use of pawnbroking loans (albeit only two per cent used them) and at higher than average risk of using home-collected loans, payday loans and subprime credit cards. Altogether, their experience of the premiums appears to relate to essential areas of expenditure and therefore **involuntary** exposure poverty premiums. For example, they are rather unlikely to incur insurance premiums, which might be considered more discretionary areas of expenditure.

Pen portrait: Cluster 3 “Involuntary premiums”

Simon and Sal are in their mid-50s. They live with 21-year old Dan in the council flat they’ve rented for most of their married lives. With Simon being long-term unemployed and Sal unable to work because of ill-health, they make do on less than **£9,800 income each year**. Where they can, they avoid spending more than they have to the costs of insurance and they couldn’t contemplate running a car. But money is tight and without the capacity to save up in advance for expected or unexpected expense they resorted to buying a replacement TV just before Christmas on rent-to-own and Sal also relies on her local doorstep lending agent and a Christmas hamper scheme to help her prepare for Christmas. At least they don’t have to worry about a large fuel bill as their prepayment meters (for gas and electricity) allow them to budget as they go and, even if they could switch supplier (which they are not sure their landlord will allow them to do), they would rather stick with the ‘devil they know’. They are lucky that a discount supermarket opened up a short walk away but they struggle without a local high street nearby and Dan has been known to take cash out at a fee-charging cash machine on occasion on evenings out with friends. The poverty premium they paid altogether last year was expected to be **£1,310**, around £13 for every £100 of their income, and **equivalent to seven weeks’ income**. Sal couldn’t imagine what she’d do with that extra cash but it would certainly take care of Christmas and take away the everyday struggle to make ends meet.

5.1.4 Cluster 4 profile: Moderately exposed: traditional money managers

Cluster 4 comprises a similar, small proportion (seven per cent) of households to the first two clusters. They incurred an average seven premiums, had the highest risk of incurring three of the premiums, and can be reasonably expected to incur a total poverty premium of an estimated £520, which makes them **moderately exposed**.

Cluster 4 dashboard: “Moderately exposed: traditional money managers”	
Seven per cent of low-income households	
<p>Premium £520 p.a. Seven premiums on average</p> <p>Defined by non-standard payment methods and paper billing for fuel and shopping premiums</p>	<p>Older, outright owners</p> <p>Not internet active</p>
<p>Poverty premium profile</p> <p>Cluster membership (%) compared with (‘v.’) the average (%)</p> <p>Above average risk of incurring 9 of the premiums, including the highest risk for 3.</p> <p>Main components of the additional total premium relative to others:</p> <ul style="list-style-type: none"> • Paper billing: £32 v. £12 • Non-standard payment method for fuel: £17 v. £5 • Not switching fuel supplier: £292 v. £233 • Area-based (especially shopping): £111 v. £83 	<p>Socio-demographic profile</p> <p>Key distinguishing household characteristics:</p> <ul style="list-style-type: none"> • Aged over 60 (63% v. 27%) • One-adult households (73% v. 46%) • Retired chief income earner (56% v. 24%) • Live in a home owned outright (55% v. 23%) • Not internet active (70% v. 35%) • Middle to low-incomes £6,500 - £17,499 (71% v. 56%)

Like cluster 2, the poverty premium profile of this cluster was defined largely by paper billing. For cluster 4, however, this related to the traditional utilities – electricity, gas and especially landlines (totalling £30) – and they were also the most over-represented of all the clusters on payment on receipt for fuel (totalling £17). They were also more likely than other households as a whole not to have switched their fuel provider in the last two years and this amounted to the largest share (57 per cent) of this cluster’s poverty premium (£294), also the largest of all the clusters. A failure to switch may be compounded by their preference for paper billing (above), a requirement for greater certainty over fuel bill costs, digital exclusion

(as most – 70 per cent – are not internet active) and an habitual, traditional approach to money management. As such, we have defined them as “**traditional money managers**”. These households also incurred the highest premium of all the clusters for food and grocery shopping (£66), contributing about 13 per cent alone to the total premium for this cluster.

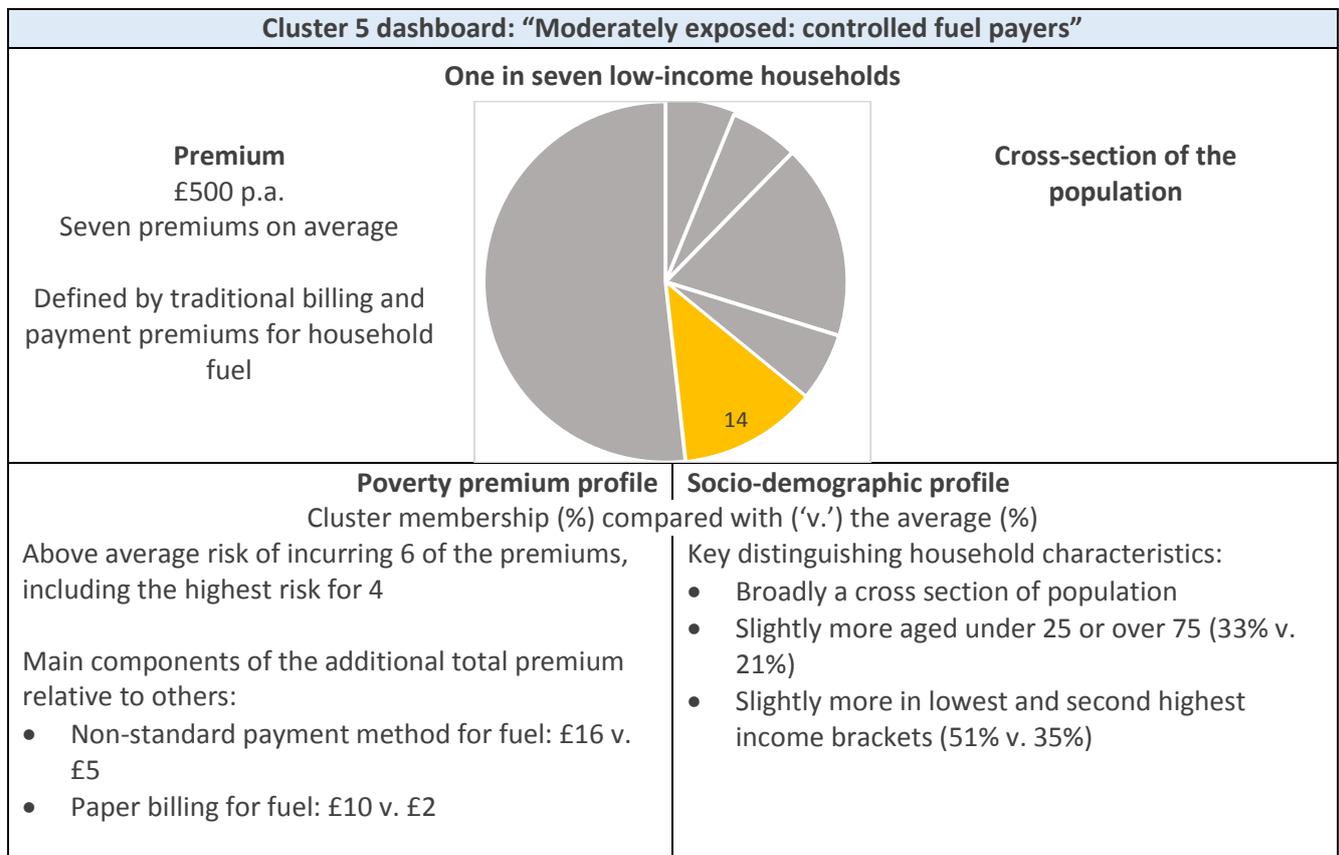
Membership of this cluster is moderately well distinguished by their socio-demographic and other characteristics. They were typically aged over 60 (63 per cent), retired, and one-adult households (73 per cent). There was a slightly increased propensity for them to be living in rural areas of Great Britain and to not be active internet users, suggesting that they were digitally excluded.

Pen portrait: Cluster 4 “Traditional money managers”

Harold’s 85 and is an active and respected member of the local community. He lives alone in the modest bungalow he built for him and his late wife some 40 years ago on the outskirts of the city. With an annual income of around **£7,800 per year** from various sources, Harold still runs a car which, until recently, was his link to independence. But failing health and a minor prang in the supermarket car park means he now only drives when his daughter can be with him and, without a good supermarket nearby, he heads to the local convenience store two or three times a week to top up the now occasional bigger shop. He doesn’t have the internet and can’t remember when he last switched fuel suppliers: he just pays his bills quarterly when his daughter tells him they are due, and he still receives a paper bill for his landline telephone. He can’t afford the annual premium for home or car insurance all at once and he instead set up a monthly payment direct from his bank account with the help of the insurance broker. The poverty premium he pays each year is estimated to be **£860**, around 11 per cent and worth **six weeks of his annual income**.

5.1.5 Cluster 5 profile: Moderately exposed: controlled fuel payers
Comprising 14 per cent of all low-income households, Cluster 5 was defined by their use of paper billing for fuel (£10; all paid their electricity bill this way), and also carried more than twice the average risk of non-standard methods of billing for fuel (amounting to a premium of £16). The focus of these households’ typical exposure on traditional billing for household fuel would appear to make them **controlled fuel payers**, although they were also at heightened risk of incurring premiums related to area-based home contents insurance (76 per cent), use of prepaid cards (five per cent), and use of home-collected loans (four per cent). While incurring an average of seven premiums, and at highest risk of all the clusters for four, with a total

poverty premium of around £500, (close to the average of £490 for all households), these households are also **moderately exposed**.



Membership of cluster 5 in terms of their demographic and other characteristics, were not especially distinct. Instead, members of this cluster were drawn from a fair cross section of low-income households. There is some indication that they were skewed slightly towards the youngest age groups (with respondents slightly more likely than the average to be aged 17 to 24) and were slightly more likely to be in the two lowest income brackets (51 per cent). It is possible that many of these, younger, adults represent house sharers (such as groups of young professionals in privately-rented accommodation).

5.1.6 Cluster 6 profile: Moderately exposed: risk-averse

Making up nearly one fifth of low-income households (19 per cent), cluster 6 is defined by exposure to **insurance** premiums, particularly for the car (£129) and home (£17), including the area-based premiums and those for non-standard billing methods for these. They also incurred a higher than average premium for insurance of specific items (£44) which tends to be more expensive than including these in

a home contents policy. Added to this, the high proportion (34 per cent) who had policies for *both* home contents and specific items suggests these households were especially **risk averse**. Altogether, insurance premiums accounted for £190, or 48 per cent, of the total premium they incurred. These risk-averse households additionally carried more than twice the average risk of using mail order catalogues (13 per cent) and a minority used subprime credit cards (seven per cent) and payday loans (three per cent).

Cluster 6 dashboard: "Moderately exposed: risk averse"		
<p>Premium £500 p.a. Six premiums on average Defined by insurance-related premiums</p>	<p>One on five low-income households</p>	<p>Middle social grades Slightly better off financially than other low-income households</p>
<p>Poverty premium profile Cluster membership (%) compared with ('v.') the average (%)</p> <p>Above average risk of incurring 9 of the premiums, including the highest risk for 3.</p> <p>Main components of the additional total premium relative to others:</p> <ul style="list-style-type: none"> • Non-standard (monthly) insurance premium payments (£70 v. £27) • Area-based insurance premiums (£76 v. £45) • Insurance for specific items (£44 v. £27) • Over-insured (the group most likely to have both contents and item insurance; 34%) 	<p>Socio-demographic profile Key distinguishing household characteristics:</p> <ul style="list-style-type: none"> • Drawn from social grades C1/C2 (60% v. 48%) • Chief income earner in full-time work (51% v. 39%) • Homeowners (54% v. 39%) • Towards top of income distribution (above £17,500) (43% v. 26%) • Live in a rural area (36% v. 23%) • Internet purchasers (69% v. 54%) 	

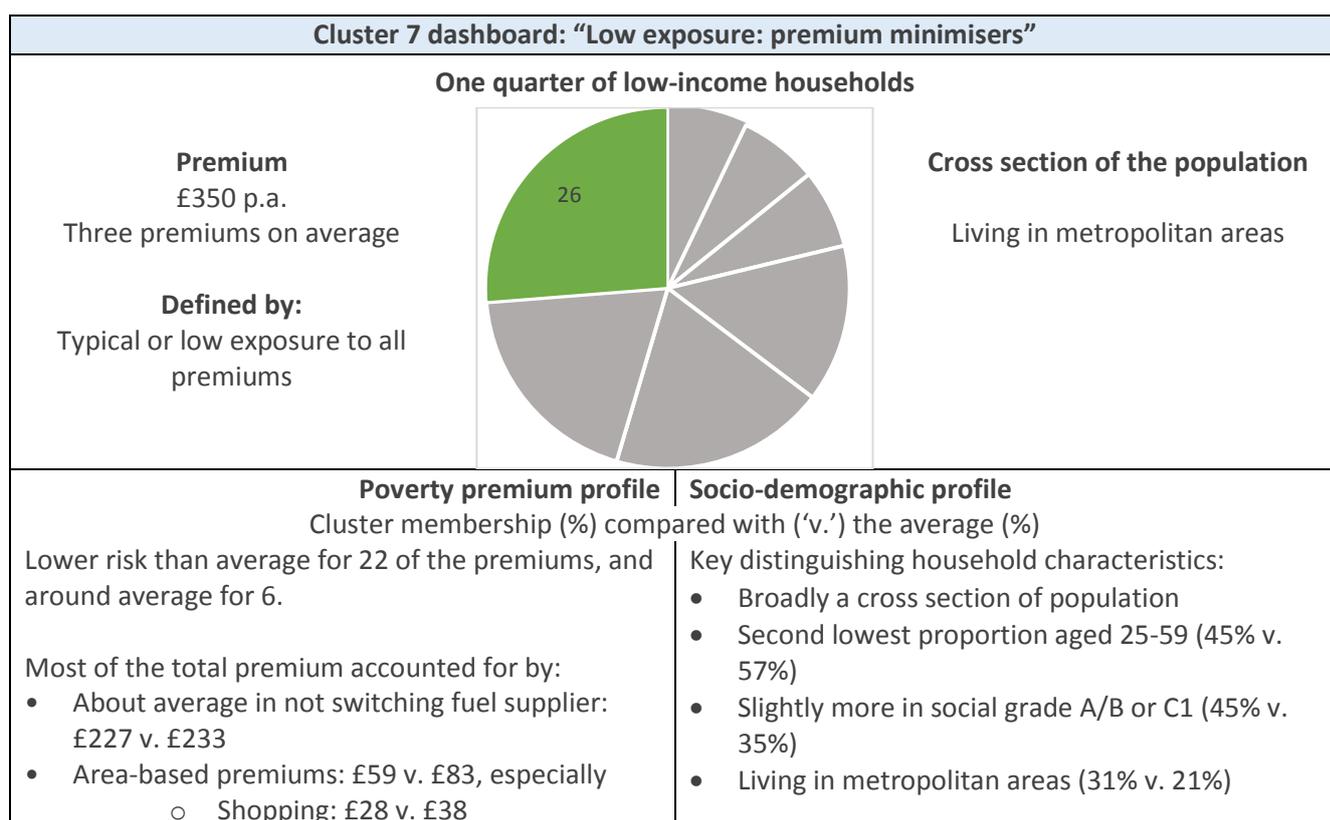
Households in this cluster were exposed on average to six premiums and were at highest risk of all the clusters for three. As with cluster 4, they incurred an average total premium of £500, close to the average for all low-income households, making them **moderately exposed**.

These moderately exposed 'risk-averse' households disproportionately comprised of those with chief income earners in full-time work drawn from middle social grades (C1 and C2; 60 per cent). They were also more likely than average to be homeowners (54 per cent) and although they disproportionately lived in rural areas (36

per cent), they also had higher than average levels of digital inclusion (81 per cent compared with 65 per cent).

5.1.7 Cluster 7 profile: Low exposure: premium minimisers

Turning finally to the largest cluster of all (at 26 per cent of all low-income households), Cluster 7 is defined by typical or lower than average exposure across all of the premiums. Their average, total premium was £350 and they incurred a lower risk than average for 22 of the premiums, and around average for rest. As such, this group on average experienced was only three individual premiums from across two categories. This does highlight, nonetheless, that none of the clusters were completely untouched by a poverty premium; it is only that exposure to them was so evenly spread across the group that it is not possible to identify where particular risks of premiums lay. We can interpret these as our **low premium exposure group**.



Most of their premium was accounted for by about average levels of not switch fuel supplier (£227; some 65 per cent of the total premium they incurred). Area-based premiums contributed the next largest share (£59), especially shopping for food and groceries (£28), albeit still below the average premium across all households (£83 and £38

respectively). As such, they appear to be **minimising** their exposure to premiums overall.

Households in cluster 7 largely represent a broad cross-section of low-income households. They were somewhat more likely than average to be young (ages 17-24) and to be drawn from middle (C1) social grades.

5.2 Overview across the clusters

This chapter has identified seven distinct clusters of low-income households based on the number and nature of poverty premiums they were exposed to. The use of a cluster analysis approach has additionally enabled us to estimate the true value of the total premium different groups experience on average, based on their actual patterns of exposure to the premiums. Two of these clusters were classed as having high exposure to the poverty premium overall, three as having moderate exposure and one as having low exposure. Our first cluster, however, was defined as having the highest exposure overall – and by some margin – and at an estimate average of £750 per year, this was 1.5 times the premium for low-income households as a whole. This was seemingly characterised by ‘active’ lifestyles, with these households also being of working age, in work, in their family years, and car owners.

The higher the exposure to the poverty premium, the smaller the cluster of households tended to be, suggesting a small core of households with the most compounding patterns of poverty premium experience. Even so, households comprising the largest cluster with low exposure overall were unlikely to be immune from a poverty premium, experiencing three premiums on average from two different types, and their exposure to fuel-related, access to money and higher-cost credit premiums were largely similar to the average for low-income households as a whole. Although this cluster was characterised by a fairly broad cross-section of households by demographic and other characteristics, some of these households’ low exposure may nonetheless be explained by deep poverty and exclusion and therefore the avoidance of expenditure which might otherwise have incurred a premium.

This might also be the case for the rather poor cluster of households, cluster 3, characterised by social renting, who – though highly exposed – were defined by their exposure to the more involuntary premiums, particularly prepayment meter and of higher-cost credit

use. Conversely, the highly exposed cluster (cluster 2), defined by their exposure to a wide range of premiums, was disproportionately comprised of working households in their family-rearing years living in homes rented from a housing association or private landlord; this suggests that these were not necessarily the poorest of low-income households overall and were actively choosing to spend in areas which nonetheless incurred premiums.

Nonetheless, the largest single premium in terms of costs incurred by each cluster was not switching fuel supplier, regardless of payment type, given the low rates of switching in each cluster. This suggests that if these premiums can be addressed, low-income households across the board have the potential to benefit from lower expenditure and, therefore, potentially a better standard of living from more frequent and more effective fuel switching. For cluster 1, which was characterised heavily by its reliance on prepayment meters, even having switched among or to a prepayment meter supplier, the gap between their tariff and the best tariff available accounted for their second largest premium and higher-cost credit, overall, accounted for the larger share still.

For other clusters the premium associated with difficulty in accessing low-cost supermarkets for everyday groceries accounted for the second largest individual premium, with only one exception. This exception was cluster 6, whose membership was defined by risk aversion management, and who incurred a high car insurance premium based both on the assumption that they lived in a highly-deprived area and because they paid by monthly instalment.

Appendix Table 5A. Average cost of premium incurred, by cluster (compared with rest)

Premium	Cost (£) of premium incurred on average adjusted for the percentage incurring this premium, by cluster							
	1	2	3	4	5	6	7	All
Use of prepayment meters	184	26	106	2	<1	9	5	38
Prepayment meter, electricity	35	9	35	2	0	4	2	11
Prepayment meter, gas	31	7	33	<1	<1	<1	<1	9
On best prepayment meter tariff	118	10	38	0	0	5	3	18
Non-standard billing methods	68	41	7	39	43	73	4	33
Payment on receipt of bill, electricity	0	2	0	9	8	2	1	3
Payment on receipt of bill, gas	0	3	0	8	8	1	2	3
On best payment on receipt of bill tariff	0	2	0	1	1	0	0	<1
Home contents - monthly payments	5	3	1	4	3	6	1	3
Car insurance - monthly payments	64	31	6	17	23	64	0	24
Not switched to best fuel tariff	149	212	264	292	259	204	227	233
Paper billing	7	43	8	32	13	5	5	12
Paper billing, electricity	0	3	0	4	5	<1	<1	1
Paper billing, gas	<1	2	0	4	5	<1	<1	1
Paper billing, landline/ broadband	5	22	56	22	2	3	3	6
Paper billing, mobile	1	16	2	1	1	2	2	3
Area-based premiums	95	118	65	111	96	99	59	83
Home contents - deprived area	8	8	2	10	9	11	6	7
Car insurance - deprived area	61	50	14	35	43	65	25	38
Difficulty accessing good value shops	26	59	49	66	44	24	28	38
Insurance for individual items	69	33	7	17	26	44	19	27
Household appliance insurance	47	20	5	15	15	25	13	17
Mobile phone insurance	22	12	2	2	10	19	6	10
Access to money	19	14	8	2	9	8	6	9
Fee-charging ATM	15	10	6	2	7	7	5	7
Fee-charging cheque-cashing	2	3	1	0	1	1	1	1
Prepaid card fees	2	1	1	0	1	1	1	1
Higher-cost credit	155	72	69	25	50	55	23	55
Rent-to-own	40	12	7	3	4	7	1	7
Payday loan	3	0	2	0	1	3	1	2
Home collected loan	39	31	35	0	24	4	5	17
Pawnbroking loan	<1	0	1	0	0	0	0	<1
Subprime personal loan	14	6	12	6	4	3	7	7
Subprime credit card	17	15	5	0	10	14	5	9
Mail order catalogues	36	8	4	15	6	23	4	11
Christmas hamper scheme	6	1	1	1	1	1	<1	1
Total	750	560	530	520	500	500	350	490
<i>Unweighted base</i>	<i>66</i>	<i>60</i>	<i>197</i>	<i>71</i>	<i>128</i>	<i>176</i>	<i>249</i>	<i>947</i>

Source: Survey, n = 947, weighted. Figures may not sum correctly due to rounding. Totals for each cluster are rounded to the nearest £10.

Appendix Table 5B Percentage of cluster incurring premiums (compared with rest)

Premiums incurred	Cluster (percentage (%) incurring this premium)							
	1	2	3	4	5	6	7	Average
Payment on receipt of bill, electricity***	-	4	-	24	21	4	4	7
Payment on receipt of bill, gas***	-	8	1	20	20	3	6	7
Prepayment meter, electricity***	99	27	100	5	-	12	5	32
Prepayment meter, gas***	90	19	95	1	1	1	1	27
Not switched to best fuel tariff***	47	67	83	92	82	64	71	73
Paper billing, electricity***	-	58	-	86	100	<1	5	26
Paper billing, gas***	1	45	-	77	94	7	2	24
Paper billing, landline***	6	94	18	100	-	6	4	20
Paper billing, broadband***	22	98	9	18	11	9	7	17
Paper billing, mobile***	6	71	11	5	6	7	10	13
Insurance for specific items***	36	15	4	12	12	19	10	13
Insurance for mobiles***	37	21	3	3	18	31	10	16
Home contents - deprived area ***	58	61	15	76	65	80	42	52
Car insurance - deprived area***	83	68	20	47	58	88	34	52
Home contents - monthly payment***	52	35	9	45	36	71	7	32
Car insurance - monthly payment***	79	39	8	22	29	79	-	31
Difficulty accessing good value shops **	10	22	18	25	17	9	10	14
Fee-charging ATM***	60	41	25	8	26	26	21	26
Fee-charging cheque-cashing*	8	9	4	-	4	3	2	4
Prepaid card	7	5	3	-	5	3	2	3
Rent-to-own***	13	4	2	1	1	2	<1	2
Payday loan	2	-	2	-	1	3	<1	1
Home collected loan**	7	6	7	-	4	1	1	3
Pawnbroking loan	1	-	2	-	-	-	-	<1
Subprime personal loan	3	1	2	1	1	<1	1	1
Subprime credit card*	9	8	3	-	5	7	2	4
Mail order catalogues***	20	4	2	8	3	13	2	6
Christmas hamper scheme***	13	2	3	3	3	2	<1	3
<i>Unweighted base</i>	66	60	197	71	128	176	249	947

Source: Survey, n= 947, weighted.

Notes. A single asterisk against a premium name indicates that exposure to the premium varied statistically significantly overall across the clusters (at the 0.05 level ($p < 0.05$)), with additional asterisks indicating higher levels of statistical significance (** indicates $p < 0.01$ and *** indicates $p < 0.001$). A highlighted cell indicates that the proportion of households in this cluster incurring this premium was significantly higher than for the rest, with increasingly darker highlight corresponding to increasing levels of statistical significance, as above. A percentage ringed by a double border additionally indicates that the percentage for this cluster was the highest or joint highest of all the other clusters) (based on post-hoc pairwise comparison tests, tested at the 0.05 level of statistical significance).

Appendix Table 5C. Individual and household characteristics of cluster membership

Individual and household characteristics	Cluster (percentage %) with this characteristic							
	1	2	3	4	5	6	7	All
Age								
17-24	15	7	9	4	18	10	18	13
25-59	81	65	73	33	50	62	45	57
60-74	4	16	14	29	17	22	21	18
75 and over	-	11	2	34	15	5	10	9
Household composition								
Single adult	3	17	23	37	23	16	20	20
Two adults	16	8	16	0	10	5	4	8
Single adult with children	15	35	22	36	24	30	25	26
Two adults with children	25	22	20	4	17	21	17	18
Three or more adults without children	23	10	9	13	19	17	26	18
Three or more adults with children	18	9	10	10	7	10	8	10
Housing tenure								
Mortgage	3	31	3	13	20	29	15	16
Own outright	3	14	4	55	29	26	29	23
Rent: local authority	39	19	38	14	9	11	14	19
Rent: private	38	22	32	6	33	25	36	30
Rent: housing association	17	14	23	9	9	7	6	12
Working status of chief income earner								
Working full time	54	40	28	24	34	51	40	39
Working part time	19	14	12	5	13	12	9	12
Retired	6	21	13	56	29	21	28	24
Not working for some other reason	21	24	47	14	23	16	22	25
Social grade								
AB	6	23	1	13	8	13	15	11
C1	18	16	8	30	27	31	30	24
C2	30	22	17	25	28	30	24	25
DE	46	39	74	32	38	27	30	41
Annual household income								
Up to £6,499	7	21	22	18	22	14	18	18
£6,500 - £11,499	24	35	44	42	29	29	32	34
£11,500 - £17,499	34	11	23	29	14	23	24	22
£17,500 - £24,999	21	24	8	6	29	20	14	17
£25,000 or more	15	8	2	5	5	13	12	9
Area type								
Rural	28	28	17	32	16	36	18	23
Suburban	31	9	28	27	27	23	20	24
Urban	30	53	29	34	32	29	30	32
Metropolitan	11	10	26	7	25	13	31	21
Use of Internet (proxy for digital inclusion)								
Used in last 3 months to buy products / services online	73	64	38	23	55	69	56	54
Used in last 3 months to search for products/services but NOT to buy products / services online	7	6	13	6	11	12	12	11
Has NOT used the internet to search for products/services	20	30	49	70	34	19	32	35
Car/van in household								
No	20	35	71	43	33	12	47	40
Yes	80	65	29	57	67	88	53	60
<i>Unweighted base</i>	66	60	197	71	128	176	249	947

6 Summary and conclusions for policy

This chapter presents a summary of our research findings, reflects on methodological approach and considers the policy implications for addressing the poverty premium.

6.1 How much is the poverty premium?

This research has estimated the poverty premium at £490 per year in 2016. This is somewhat lower than the nominal poverty premiums calculated in previous studies such as those of Save the Children (2007, 2010). Most crucially, the adjustment of the calculated premium by the number of households incurring it, thereby producing an average incurred premium rather than a nominal, illustrative premium of the highest possible poverty premium.

Low-income households varied in their exposure to the premiums, with some clusters experiencing an average of only three premiums, while some incurred an average of eight. As such, the methodology used here has provided a more nuanced and sensitive measurement of the premium poverty premium than has been possible in the past.

6.2 How does it impact?

£490 per year is undoubtedly a significant sum to low-income households. It might represent a family holiday, enough clothes and shoes for the children, keeping the home warm in the coldest winter months, all things considered important for a reasonable quality of life and avoidance of social and material deprivation. Moreover, the evidence suggests that were low-income households' disposable incomes to rise by a similar sum, then it would be spent on essentials such as these (Save the Children, 2007). As such, the premium represents significant disadvantage additional to poverty itself.

6.3 How is it composed?

The calculation of the poverty premium has taken into account costs associated with household fuel, insurance, telecoms, food and grocery shopping, access to money and use of higher-cost credit. We have primarily understood the poverty premium in relation to the factors which underpin – and drive – it. This has enabled us to

distinguish eight types of premium based on the extent to which they are more or less imposed on low-income households or driven by the complex choices households find themselves making. These are:

- Use of fuel prepayment meters (imposed)
- Use of non-standard methods of bill payment (excluding fuel prepayment meters) (imposed and choice)
- Not switched to best fuel tariff (imposed and choice)
- Paper billing (choice)
- Area-based premiums (imposed)
- Insurance of individual items (imposed and choice)
- Access to money (imposed and choice)
- Higher-cost credit (imposed and choice)

The largest share of the average premium incurred by low-income households related directly to low-income households' not switching household fuel supplier in the last two years (an average of £233 across all households; calculated at £317 among those who had not switched). This was compounded by other, albeit much smaller, premiums associated with households' fuel payment methods. And, even a household which *had* switched to the best prepayment meter tariff could still expect to incur an estimated premium of £227 compared with those available in the best online direct debit deals.

In addition to fuel, components of the poverty premium which were associated with insurance contributed comparatively large amounts to the average premium incurred – this was particularly true for car insurance, even taken into account that only just over a half of households had one or more vehicles. A shopping premium arising from households' difficulties in getting to low-cost supermarkets was also a large contributor to the overall premium, despite most low-income households not incurring this.

That said, although it was unusual for households to have used sources of high-cost credit, those who did were subjected to the highest costs overall – up to £540 per year for some types of borrowing. This highlights the large impact of some individual components of the premium on a small minority of the households potentially most vulnerable.

6.4 Who does it impact?

In fact, exposure to the poverty premium and the costs incurred are highly nuanced. Clear evidence that the poverty premium does not fall evenly across households comes from the findings that, while 26 per cent of low-income households incurred a premium of only £350 on average, one particularly vulnerable group incurred £750 on average (1.5 times the premium for low-income households as a whole).

These very highly exposed households were defined by prepayment meter, insurance and money premiums and tended to live in homes rented from housing associations (suggesting they are among the poorest of households'), in their family years (suggesting they have some of the highest demands on their incomes) and internet active (suggesting they may already have been doing what they could to shop around and switch deals online where possible).

Other household clusters were, variously, defined by disproportionately high exposure to insurance premiums, receipt of paper bills, money management and other aspects of a fuel premium.

It is important to highlight, however, that even within each cluster, some low-income households were at risk of incurring a much higher premium than the cluster average (and others less). In one illustrative example (based on a real 'very highly exposed' household surveyed), the calculated premium was £1,860 on a total annual household income of only £16,500.

6.5 Calculating the premium: some limitations – and strengths

The difference between previous estimates of the poverty premium, and the total poverty premium produced here is due principally to the adjustment of the nominal costs associated with each component of the premium by the proportion of households experiencing the premium. In other words, the current study has taken a more nuanced approach to the calculation of the premium, where £490 reflects the average poverty premium incurred across households, rather than a nominal, hypothetical costs.

There are, however, other reasons why the premium calculated here should be different from previous estimates. One is methodological, and relates to the particular underpinning assumptions and methods of calculating costs associated with a particular premium (for

example, assumptions about the baseline costs incurred by higher-income households, or the number of consumer borrowing products taken out within a year). The other is contextual, in producing an updated cost of the poverty premium we have reflected changes in markets: for example, digital inclusion has increased (Dutton and Bank, 2013), but so has the number of prepayment meters installed in homes (This is Money, 2015); and controls have been introduced to cap payday loan charges and align prepayment meter tariffs with standard billing.

As such, it is perhaps not a 'true' cost to any particular household – and is instead indicative – but, by being applied in a transparent, standardised way, allows for comparisons across household types and over time.

It is important to remember that the poverty premium reflects the additional costs low-income households pay for goods and services compared to those on higher incomes. It does not take into account the extent to which low-income households avoid paying poverty premiums because they cannot afford to and simply 'go without'. The benefit of extending our research to low-income households (to include households with incomes slightly above the poverty line) is that our findings suggest that households who are most highly exposed are not necessarily those on the lowest incomes, but incur the highest poverty premium because they consume more e.g. have car insurance and use high-cost credit.

By making the methods of our calculation of the poverty premium fully transparent and replicable, they are available for us and other researchers to re-examine the poverty premium in the future.

6.6 Why does it arise?

The poverty premium arises for a mixture of reasons which relate broadly to the needs and preferences of low-income consumers and supply-side market structures and cost-reflective pricing. The extent to which these premiums are avoidable for households is questionable. At least at a high level, household fuel represents an essential cost for households, and insurance is a sensible protection against potentially much greater losses. Households who cannot easily access low-cost grocery stores or banks and building societies, particularly those without access to private transport, may have little option but to shop in more expensive convenience stores and cash cheques in local fee-charging

cheque-cashing stores, for example. They might prefer to avoid using higher-cost credit, but where spending is driven by necessity this may prove difficult.

Digging deeper, households might benefit from switching fuel suppliers or moving away from prepayment meters. However, tight budgeting preferences and risk-aversion can make this difficult for low-income consumers. As such, these options may represent a false choice; and they may be compounded by digital or financial exclusion. Moreover, in the case of prepayment meters it may be a forced choice, imposed on households' by their provider after falling into arrears or – indirectly – by their landlords.

Nonetheless, there are potential interventions which government and the relevant industries might take to support and enable households to reduce and avoid the poverty premium, as the following section identifies.

6.7 Implications for policy and practice

This study makes an important contribution to our understanding of the scale of the poverty premium and households' lived experience of it. It provides a much more nuanced and detailed picture of the poverty premium as experienced by different types of low-income households and provides a much-needed 'proof' that the poor are not an homogenous group. In particular, it highlights how important it is to distinguish those who regularly use higher-cost consumer credit from those who do not, as this makes a very big difference in the size of the premium incurred overall, and throws into sharp relief the easy assumption that most or all low-income households use higher-cost credit. The analysis provides a clearer focus on the range of overall costs experienced in core areas of household expenditure and by different clusters of households.

In policy terms, a particular challenge facing the UK (and elsewhere) is that increasing 'marketisation', and the current emphasis on switching as a solution to perceived market failures (CMA, 2015b), implies an increasing responsibility on households not to incur a premium, rather than on suppliers not to charge it and industry bodies and government to regulate it. It is likely that low-income households are the least equipped to avoid it. The supply and provision of goods and services does not adequately account for how people on low incomes often prefer to manage their money, or their

sensitivity to the risks associated with how they manage their money or pay for goods and as such indicates a market failure.

It is positive that fewer low-income households are incurring individual poverty premiums than might previously have been expected. The finding that advances in technology are likely to have reduced and removed certain premiums, particularly in the field of telecoms, is encouraging and the lessons from sectors such as this can be capitalised on for learning in other fields. Requirements for improvements in information provision, for example new requirements on insurers to provide last year's premium on insurance documents, may well play a positive role in the future.

However, the findings of this research suggest that there is still scope – and, in cases, substantial scope – for the poverty premium to be reduced in some areas, and there is a role for providers, government and regulators to help address it. Understanding the underlying reasons *why* a premium arises is crucial. Central to the solution may be striking a better balance between cost-reflective pricing and cross-subsidy, where cross-subsidy is possible, and roles for greater partnerships and trusted intermediaries. When applied to the poverty premium areas, for example:

- People often 'choose' paper billing to ensure that they retain control. While the comparatively small charge for paper billing came about originally through the introduction of cost-reflective pricing, the reduction in the number of people affected and a heavy concentration among households on low incomes, may suggest that utility providers should now reconsider the practice.
- Area-based premiums are a particular area where partnerships with local end providers may be key to the solution. To reduce the relatively high premium for households who find it difficult to access good value shops, for example, there is scope for the major supermarkets to work in partnership, as wholesalers, with privately-owned neighbourhood shops (as well as introducing more local, convenience stores with greater pricing parity with their larger stores).
- The proportion of households paying to access cash or using higher-cost credit suggests that mainstream providers have more to do more to extend their financial inclusion reach.

The clearest priorities for action relate to insurance, higher-cost credit, and fuel, where the costs of the premiums experienced are generally high and, particularly in the case of fuel premiums, exposure to them is also high. In many instances, these premiums are also imposed.

Insurance

The poverty premium associated with car insurance is particularly high, and the more providers can move towards risk-based pricing which, for example, rewards drivers based on their behaviour the more scope there may be for reducing prices to those living in high risk areas. The additional cost of paying for car and home contents insurance monthly (rather than annually up front) is around 10 per cent, and the extent to which this premium is cost-reflective may need investigating.

For insurance more generally, there is a role for low-cost, 'low-frills' products which are reflective of lower levels of cover needed. Home contents insurance schemes provided by or offered through social housing providers is an example of the potential role of intermediaries in reducing costs to low-income households (by pooling risk), although more needs to be done to understand and address why take up of these products has been traditionally been low (e.g. Vestri, 2007). And there is a case for an investigation into the market for individual-item insurance to identify the extent to which it might be exploiting risk aversion and creating user detriment; remedies might include a requirement on insurers to check whether a customer has existing insurance cover.

Higher-cost credit

A significant minority (16 per cent) of low-income households had used at least one source of high-cost credit in the last year and, when incurred, the premium for individual types was as high as £540 per year. The high cost of rent-to-own stores, home collected loans and subprime personal loans suggests these are particular areas for future investigation by the Financial Conduct Authority. However, the wider landscape of credit provision is also important.

Within the current structure of affordable credit provision, credit unions and other community lenders play an important role in serving people on low incomes. A major programme of credit union modernisation (by the Association of British Credit Unions, launched in 2013 with £38m Government funding) proposes to expand their

reach and save consumers up to £1 billion in loan interest repayments by 2019.²³ Partnerships play a particular a role in linking potential customers with credit unions. For example, while there are challenges to be overcome, employers working with credit unions to provide payroll deductions for loan repayments and housing associations have partnered successfully with credit unions and other community lenders to offer affordable credit to tenants (Hartfree et al., 2016).²⁴

Despite this, however, the reach of community lending remains limited and supply cannot always meet demand. The provision of credit which meets the needs of low-income consumers is costly and requires significant investment. Through their corporate social responsibility function, businesses – working with charities – have the potential to offer no and low interest micro loans to the most financially excluded consumers, as has happened in Australia and Ireland (StepChange, 2016). There is scope for social investors to invest in and offer innovation in alternatives to high-cost credit (such as Fair Finance, and FairForYou which launched in December 2015 as a social-interest competitor to the high-cost rent-to-own market).²⁵ There is also a case for direct intervention from Government, for example, to develop a large-scale offer of mainstream, affordable credit products which enable people in a range of circumstances to borrow sustainably (StepChange, 2015). Moreover, there is a role for Government in helping low-income households avoid the need for credit to cover lumpy expenditure by supporting them to put aside a modest savings safety net.²⁶

With financial inclusion both a social and a business problem, there is an imperative on organisations, including regulators and financial institutions, to work together to develop new solutions and novel products to address the mismatch between provision and need and make full financial inclusion a possibility (Cohen et al, 2015).

²³ <https://www.gov.uk/government/news/credit-union-38-million-expansion-deal-signed>

²⁴ PwC is partnering with Citizens UK to launch 'Just Money', a credit union-employer linked payroll deduction pilot scheme for both saving and borrowing, in 2017.

²⁵ Fair Finance (www.fairfinance.org.uk) is a 'social business' offering affordable personal loans and other financial products to the financially excluded. FairForYou (www.fairforyou.co.uk) is a not-for-profit Community Interest Company operating nationally online to offer low-cost loans on goods bought through its own online shop, funded through commission from manufacturers.

²⁶ Also proposed by StepChange (2015), who suggest a rainy day savings buffer of £1,000 per household.

Fuel

Accounting for the largest share of the poverty premium, equivalent to an average of £279 per year per low-income household, reform of the fuel market is a priority area for action.

Previous studies on the poverty premium have highlighted how customers who use prepayment meters face higher charges than those who pay by monthly direct debit; this is still the case. The problem in relation to prepayment meters is that, while costly for suppliers, they are largely imposed on households. This argues for the development of mechanisms for fuel arrears management which do not at the same time penalise customers in difficulty. This requires innovation and investment from industry.

Meanwhile, although the alignment of prepayment meter tariffs with standard billing tariffs has been a positive step, standard billing tariffs remain more expensive than monthly direct debit billing which means that prepayment meter users and standard billing customers are still disadvantaged. In this respect the Competition and Market Authority's proposed temporary price cap on prepayment tariffs (CMA, 2016) is to be welcomed, but suggests that customers on standard billing tariffs may still be penalised. Furthermore, if the cap is set at a level in line with the cheapest available prepayment tariffs, customers will still be paying more (by our estimate £227 per year more) compared to the cheapest monthly direct debit tariffs. While there are new suppliers entering the market who are charging the same tariff across payment methods, and the rollout of smart meters provides the opportunity for more competitive deals, the success of these suppliers in addressing the fuel poverty premium largely relies on them being able to persuade low-income households to switch to them.

Therefore, a much greater issue in relation to fuel premiums is the penalty low-income households incur for not switching. Households who pay by monthly direct debit can save £317 per year by switching from an expensive standard tariff to one of the best (fixed-rate) deals. Households on a prepayment standard tariff could save even more. Digital applications which facilitate switching (such as USwitch and Voltz, which extends to prepayment meters) have a role to play. However, the need for consumers to be vigilant and active in the energy market to obtain the best deals penalises low-income households who have valid reasons for not switching. The Competition and Market Authority's proposals to increase

engagement in the energy market by allowing rival suppliers to contact those who have been on a standard tariff for more than three years (CMA, 2016) does not address all of these issues.

Our findings suggest encouraging consumer engagement in the energy market will not be sufficient to eradicate the fuel poverty premium. The alternative solution is for market regulation that prevents energy companies from leaving customers on expensive standard tariffs when much cheaper tariffs are available. Another solution proposed (JRF, 2016b) is the encouragement and promotion of collective switching schemes run by trusted intermediaries (such as housing associations, community groups and local authorities) who use their collective buying power to negotiate a better deal from energy suppliers and support customers to switch.

6.8 Where next? Concluding thoughts

Overall, a primary concern, and possibly an increasing concern, for the poverty premium is that purely market-driven consumption in the existing supply structures will increase the vulnerability of those who are already susceptible, while also placing greater responsibility on those same households to avoid or deal with their disadvantage. Central to tackling the poverty premium is recognising that low-income households have particular needs around the way they manage their money and that products and services designed for middle or higher-income customers may automatically disadvantage them.

As such, the poverty premium in some areas is underpinned by lack of true competition and innovation which meets the needs of low-income consumers. Working with the Joseph Rowntree Foundation, Big Society Capital has announced that it is scoping a programme of funding to explore opportunities for corporate and social enterprise organisations with an interest in low-income customers to develop and scale up interventions that address the poverty premium.²⁷

The poverty premium can only be addressed through the collective commitment of industry, policy makers and regulators. The solutions will most likely involve small steps in each of the affected areas. However, some steps may need to be radical if markets are to bring

²⁷ <https://www.bigsocietycapital.com/what-we-do/investor/partners/co-development/poverty-premium>

about greater parity in pricing structures, while balancing the needs of those who need to pay less and those who end up paying more.

Recognition of the poverty premium as a driver of the experience of poverty is critical to its solution.

Finally, this study has made an important contribution by making the methods of the calculation of the poverty premium fully transparent and replicable. The methods are being made available openly for all, to enable researchers to re-examine the poverty premium in the future, and facilitate routine monitoring of the scale of the problem.

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