WORKING PAPER

Affordable credit for low-income households

Literature review and re-analysis of existing interview scripts

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1 Introduction

Despite large increases in the levels of consumer borrowing over the past ten years, many households on low incomes have constrained access to the sources of mainstream credit used by others. People who are not working are very likely to have applications for any form of mainstream credit rejected and most do not, therefore, even bother applying. Moreover, even people who have overdraft facilities or credit or store cards when they are in employment almost certainly stop using them if they cease working.

Yet a recent survey of consumer borrowing found that levels of credit use do not differ much at all by household income (Kempson 2002). However, both the reasons for borrowing and the sources of credit used do vary quite considerably.

In general, people use unsecured consumer credit to spread the cost of non-essentials - in other words to finance consumerism. In contrast, people on low incomes are much more likely to use credit to meet the costs of necessities – to overcome financial hardship. Recent research has identified four main reasons why people living on Income Support or Jobseeker's Allowance had borrowed money:

- to buy household appliances, furniture or clothing they needed to replace;
- to pay bills;
- to make ends meet; and
- to meet the costs of discretionary items, such as Christmas, birthdays or other family events and, occasionally, to go on holiday (Whyley et al, 2000).

While many people on low incomes do have a choice of credit sources to meet these needs, on the whole it is restricted to sources that are high cost and have other associated disadvantages. The most widely used is mail order catalogues – especially by low-income families with children. It is also an important means of buying goods for low-income pensioners. Other forms of commercial credit that are aimed specifically at people on low-to-middle incomes, include two established sources - home credit and pawnbroking – and two newer ones – sale and buy back and rental purchase. Pay day loans are also a new form of credit but tend to be used by people who are slightly better-off.

The two sources of low-cost credit potentially available to people on low incomes – the Social Fund Budgeting Loan scheme and credit unions – are both restricted in their access. Budgeting Loans are only available to people who have been receiving either Income Support or income-based Jobseeker's Allowance for at least 26 weeks. As the Social Fund budget is cash-limited each year, applying for a Budgeting Loan is often compared to playing the lottery. Despite great hopes to the contrary, the development of community-based credit unions remains patchy in most of Britain, and especially so in England and Wales. While there are a handful of large community credit unions, the majority are small-scale and many communities have no access to one at all.

It is important, however, to recognise that people do not use high-cost credit just because they have no choice. There some attributes that can make these sources of borrowing more attractive than mainstream credit – and particularly running account credit such as credit and store cards or overdrafts. Likewise they identify some important drawbacks with existing sources of low-cost credit.

In the sections that follow (2 to 7), we outline the main attractions and drawbacks for each type of credit that has been identified from previous research among people living on low incomes. We end (in section 8) with a distillation of the ideal features of an affordable source of credit for people in this situation.

2 Mail order catalogues

On the whole, mail order was the most acceptable of the sources of credit available to people on low incomes. Indeed it was often the only source that people used – especially among pensioners and people from some ethnic minorities.

The majority of people who used mail order did so through choice, although a minority bought things this way through constrained access to high street credit – and access to in-store credit in particular. At the same time, use of mail order catalogues was not without its drawbacks, although some of these were common to other forms of credit as well.

A key drawback, of course, is the fact that this form of credit is linked to the purchase of goods. Yet people on low incomes often need cash loans for things not included in catalogues.

The attractions of mail order catalogues

Mail order catalogue users identified a number of reasons why they found them a convenient and attractive way of buying things. Above all, they were seen as a good way of spreading the costs of goods they needed to buy but couldn't otherwise afford, either when money was short or on special occasions, such as Christmas or birthdays. They also offered a convenient way of shopping for people who found it difficult to get to a shopping centre. Users considered the repayment schedules to be low risk compared with other sources of credit. If they could sign up as an agent in their own right people did so for the commission they could earn. At the same time, they were accessible to people who might otherwise find it difficult to get access to lower-cost credit as they could be used through a third party. And finally, mail order catalogues were attractive to Muslims because they complied with Islamic teaching.

Spreading costs

Many low-income families, in particular, find it difficult to buy clothes, household goods and Christmas or birthday presents from their regular income. They therefore value the fact that they can buy these through mail order catalogues and spread the cost over six months or a year.

This applied especially to parents faced with demands from children for designer clothes and footwear and the latest toys or gadgets. They wanted to protect their children from bullying at school for being different, but could otherwise not afford to buy the things that would protect them (Collard and Kempson, 2003; Herbert and Kempson, 1996; Jones, 2002; Kempson et al, 1994; Morris and Ritchie, 1994; Speak et al, 1995; Speak and Graham, 2000; Whyley et al, 2000).

Convenience of shopping from home

Many users of mail order valued the fact that they could buy on credit from their home. This applied especially to elderly and disabled people.

> *I'm disabled and find it difficult to get about. I can try things on at home without charge.* (Jones, 2002)

It also applied to those living in rural areas, who did not have transport of their own. (Herbert and Kempson, 1996; Jones, 2002; Kempson et al, 2002; Rowlingson, 1994; Whyley et al, 2000).

In addition, previous research has shown that people with low incomes who live on urban housing estates are reluctant to visit either city centre or out-of-town shopping centres. In part this is because of travel difficulties but it is also because people feel uncomfortable there.

> *There's nothing for me there. It's just depressing… [makes me] feel tatty.* (Speak and Graham, 2000).

Low risk

There were several ways in which mail order catalogues were seen as a source of low risk credit. First, many people felt that there was a lower risk of running up large commitments than there would be if they used a store or credit card. Indeed, some people did not see mail order as a source of credit at all. In contrast, a credit or store card was seen as an invitation to spend money that was much more difficult to curb (Kempson et al, 1994).

Secondly, people were attracted to mail order because they knew exactly how much they would pay for the goods they bought and the fact that the money was to be repaid in known fixed amounts over a fixed period of time. This made it much easier to plan purchases and avoid becoming over-committed. Again this was in contrast to using credit or store cards, where people feared being tempted to make just the minimum payment and never really reducing the amount they owed (Jones, 2002; Kempson et al, 1994; Whyley et al, 2000).

Thirdly, people who bought things through a third party – either as a customer or more informally – said that they were much less likely to miss a payment than would be the case if they were paying direct to the company.

> *I'm in closer contact with [the mail order agent], so I'll pay it. But if it was a shop, I'll think, 'Well they're not going to come round my house, I'll miss that one'. But I know she would.* (Kempson et al, 1994)

Loyalty to friends or relatives meant that they tended to pay on time even if money was short (Jones, 2002; Kempson et al, 1994).

> *Getting it off my Mam, you got to pay it, like. I wouldn't let her down.* (Jones, 2002)

Fourthly, some people had found mail order companies sympathetic to rescheduling or extending their credit term if they were struggling with repayments. (Jones, 2002; Kempson et al,1994).

> *They're alright about missing payments. They are sort of fair. Sometimes I pay as much as I can.* (Jones, 2002)

Commission

The commission that people can earn by becoming an agent was an added attraction and this money was often saved until agents needed to buy something for themselves (Herbert and Kempson, 1996; Kempson et al, 1994; Whyley et al, 2000). However, relatively tight credit scoring means that many people on low incomes are refused when they apply for agency status. Consequently, this advantage applies to only a minority of mail order catalogue users.

Accessibility

Most mail order users, who were not agents in their own right, were attracted by the access they could gain to credit through a friend or relative. In some cases they signed up as customers of someone they knew who was an agent; in other cases they bought things in the agent's name and then paid them the money informally.

Islam compliance

A survey of credit use among ethnic minorities found that use of mail order catalogues was lower in Bangladeshi and Pakistani households than in either African Caribbean or white British ones. In the main, this was because in these Asian households credit commitments tended to be taken on by men, while mail order is mainly used by women. In contrast to other forms of consumer credit, buying goods on mail order was more acceptable to Muslims. This was because the cost of spreading repayment is structured as a price mark-up rather than an interest charge, and therefore means that it complies with the Islamic teaching on not paying interest (Herbert and Kempson, 1996).

The drawbacks of mail order catalogues

On the whole, buying goods through mail order was perceived as having fewer disadvantages than other sources of credit that were available to people on low incomes. People who chose not to use mail order catalogues did so for several reasons. These included fear of over-commitment, the extra costs incurred by defaulting on repayments, and costs in general. People who bought clothing sometimes cited as a disadvantage the risk of buying poor quality goods or items that did not fit.

Risk of over-commitment

We saw above that many people felt better able to control their spending by using a mail order catalogue rather than a credit or store card. Other people, however, would not use mail order catalogues at all because they were concerned about over-spending. They included people who were opposed to any form of credit but also those who had, in the past, over-committed themselves with mail order purchases (Jones, 2002; Kempson et al, 1994).

> *You order it and then you don't think. And then the time comes you've got no money to make the repayments. So I'm not doing that any more.* (Kempson et al, 1994)
>
> *When I'm depressed, I just flick through the catalogues and buy things.* (Jones, 2002)

A minority of people found themselves in a cycle of juggling with repayments on more than one catalogue.

> *I'm waiting 'til [the mail order companies] take legal proceedings against me. I'm getting into a right mess at the moment. That's why I'm taking out another catalogue so I could get [the children] some clothes… I will probably take the commission out of those two catalogues to pay for the other one.* (Kempson et al, 1994)

Cost of default

Those who had defaulted on payments discovered that they were charged interest on the missed payments – which only made a bad financial situation worse. Some people also found their catalogue company unsympathetic when they tried to negotiate a means of repaying the money they owed (Kempson et al, 1994).

Costs generally

Goods bought through mail order catalogues and repaid over 20 or 40 weeks are, technically, interest free. In practice their price is often a good deal higher than identical items for sale in the high street. People were aware that it could be an expensive way of shopping – especially if they chose to spread the payments over a year rather than six months (Jones, 2002; Rowlingson, 1994; Whyley et al, 2000).

> *Things are quite a lot dearer in the catalogue, comparing with a shop… Like on games and things for children, for example, it can be as much as £5 difference.*

If repayments are spread over more than 40 weeks, interest is charged at 28.8 per cent or more (Jones, 2002). Moreover, one mail order company reportedly makes an additional interest charge for an appointed company representative to call on customers in order to take orders and collect payments, tasks usually carried out by an agent (Lord, 2000).

Problems with clothing

A number of people preferred not to buy clothing from mail order catalogues because they could check neither the quality nor how well things fitted before buying them.

> *I don't like catalogue clothes very much for the simple reason that they're expensive and they're cheap. They're expensive to buy but they're cheap material.* (Kempson et al, 1994)

They could, of course, return items of clothing if they were unsuitable, but the costs involved and the lack of another option for buying the things they needed meant that, in practice, they rarely did. (Herbert and Kempson, 1996; Kempson, et al, 1994; Rowlingson, 1994; Whyley et al, 2000).

3 Home credit

The high rates of interest on home credit have sometimes caused speculation that customers must have no other choice but to borrow from this source. Previous research has found, however, that there were many aspects of home credit that customers greatly appreciated.

The attractions of home credit

The main attractions of home credit are four-fold. It is a familiar source of credit that is straightforward to access. It offers small cash loans that can be repaid weekly in cash. Payments are collected from customers' homes which, apart from the convenience, reduces the chances of default. And lenders are willing to reschedule loans should customers be unable to meet the repayments.

A simple, fast, familiar system

One of the main advantages of home credit, according to current customers, was that the system was very familiar to them and the application process straightforward.

Many customers had used home credit for years and so had members of their family and friends. Tebbutt (1983) provides a historical account of pawnbroking and home credit in the 19th century and, in a number of recent studies, customers can point to home credit being used by many previous generations. It was, therefore, a familiar form of credit and the risks of using it were thought to be minimal. For people with little money, lack of risk was important. A number of customers used the phrase: *'Better the devil you know'* (Rowlingson 1994).

There were no complex forms to fill in to get access to credit as there were with Social Fund loans and bank/building society loans. Proof of income or identity was not needed and this was seen as an important protection of privacy. It was possible to get a loan within a week, a very important consideration for people living with short financial time horizons.

> *You can ask them for a loan on the Friday and they'll be out here by the Monday … and they'll give it to you that day, it's convenient.* (Rowlingson 1994)
>
> *The Provvy's fast cash, reliable and will always say 'yes'.* (Jones 2002)

Small loans, repaid weekly in cash

Following on from the previous point about lack of risk, customers felt that the availability of small loans, repaid weekly, gave them control over their use of credit. Customers did not want to borrow the large amounts offered by banks (even if they were eligible to do so). They were nervous about over-indebtedness and so preferred to borrow small amounts on a regular basis. For similar reasons, many home credit customers were highly suspicious of credit cards, which they thought might lead to a high level of debt. The weekly payment period also suited people whose income was often received on a weekly or fortnightly basis. Customers felt that if they had to make larger monthly repayments they would struggle.

> *'Because I'm paid weekly it would work out difficult for me because I'd have to put my money away each week … it would be hell, you know. It's alright if you're paid monthly isn't it? But if you're not it would be a bit of a bugbear.'* (Rowlingson 1994)

One customer was repaying £3 a week and felt that this amount would easily be lost on other spending if it wasn't going to the doorstep collector. The cash basis of the system was also appreciated by many customers who disliked using banks and preferred to keep control over their finances by sticking to cash.

Home collection

Customers valued home collection because it was convenient. This was particularly true for people with mobility difficulties (e.g. older people, disabled people, people with children and no car) who said they would not like to have to travel to a post office or bank branch to make payments. Customers also said that the home visit enabled them to maintain payments. If they had to send money off in the post or take the money to an office somewhere there would be a greater chance of missing payments and then losing access to future credit.

> *'I'd rather have someone I know rather than traipsing round to post offices and banks paying in. So he was more convenient and I knew him before so I trusted him in that way, so I was quite happy.'* (Rowlingson 1994)

Once again, the importance of keeping control over one's money was highlighted in relation to home collection.

> *'The convenience of having someone call here … you know you can't leave it because you know somebody's going to call. And personally I think that's probably how a lot of people do get into debt because they know, 'oh no-one's going to come knocking on my door, so we can leave it another week,' and it just builds up … It's a bit like the old rent collector, isn't it? I mean, they didn't have the arrears with the old rent collectors.'* (Rowlingson 1994)

> *'I don't dread now getting into debt. I feel through him I can control my spending.'* (Rowlingson 1994)

Collectors normally timed visits so that the customers had money available to repay their loans (e.g. on benefit day or pay day). This was thought (by all collectors and most customers) to be in the best interests of the customers and the collectors.

Contrary to the image of a threatening 'loan shark', many customers appreciated the friendly nature of the collector they were dealing with – who was often a woman like themselves. Older people were particularly pleased to have a friendly visitor once a week.

'The Provvy collector goes to the lunch club and the bingo. She's a real friendly, normal person.' (Jones 2002)

'There was one chap, I'll never forget him… and he'd sit and he'd say, 'come on then, let's have a cup of tea.' A lovely chap he was and he thought the world of [our daughter] … and when he got up to go he used to put up three sixpences and say, 'give them to the nippers.' I never forgot him.' (Rowlingson 1994)

Payment re-scheduling

An important attraction of home credit was the fact that, unlike bank loans and credit cards, there were no additional charges if payments were missed.

'If you can't afford to pay you don't get the interest added on anyway which you do for the bank.' (Rowlingson et al)

'I'm supposed to pay £12 a week but I don't. I pay £6 … It's either that or nothing. He knows.' (Kempson et al 1994)

Customers said that the collectors were understanding if they missed payments occasionally and they appreciated this approach. Indeed, home collection companies often cite the fact that, on average, a 26 week loan is repaid over 30 weeks.

The drawbacks

There were, however, some important drawbacks to the use of home credit. These included its high cost, relative to other sources of credit; the encouragement of further borrowing; the obligation to pay; and, again, home collection. These factors deterred some people from using home credit at all. But they were commented on by users as well.

Cost

Undoubtedly, high cost was one of the main reasons why many people on low incomes would not use home credit at all (Collard and Kempson, 2003; Jones, 2002; Kempson et al, 1994; Whyley et al. 2000). They variously described the cost of home credit as: *'absolutely colossal', 'extortionate', 'massive.'* Some of these views were based on previous experience of using home credit. In other cases, people knew by word-of-mouth or assumed that the costs were very high.

Cost was also the main disadvantage cited by customers of home credit. Although they had little real understanding of the APR, almost all knew the total cost of their loan and that they were paying dearly for this form of credit.

'The charges are massive. If I borrow £100, I've got to pay £150 back.' (Jones 2002)

On the whole, though, the level of the weekly payment and whether or not it was affordable was the most important consideration, not the APR or the total cost of credit.

> *'The cost of credit is not important when money is needed straight away. Most people do not understand APR.'* (Jones 2002)

Home credit customers were prepared to pay the cost either because they had no other choice or because they consciously chose to pay more to get the type of service they preferred.

> *'I do think it's a lot on top. Like I said, £160 what he said was available at the moment. I'm sure it was £240 odd, you know, you pay back. It's a lot of interest again. And some people, like maybe even me this year, will have to have it because of the grandchildren really. You have to have it and you're paying all year then and before you know it it's Christmas again.'* (Rowlingson 1994)

Even some of those who no longer used home credit said that they might pay the very high cost of credit if they needed something urgently, like a washing machine (Collard and Kempson 2003).

Users of home credit also disliked the removal of the first payment or a bank holiday payment from the initial loan. This was not a universal practice but did occur with some companies. Insurance payments were also criticised.

Encouragement to borrow more

Some customers had come across collectors who were pushy or unfriendly though none of the current customers interviewed said that their current collector came into this category (Rowlingson, 1994). But customers found that even the friendly collectors sometimes encouraged or pressurised them into taking out more loans and/or higher loans than they really wanted.

> *'He'll say, 'do you need more decorating done?' or 'don't you fancy a new carpet?' or something, you know, silly things. Of course, sucker, you fall into it.'* (Rowlingson 1994)

> *'They always come round at the right time when you need money and you've got no choice. I mean, Christmas, there was nothing I could do.'* (Kempson et al 1994)

Even when a customer had already decided to take out a loan, the collector might encourage them to borrow more money than they had originally asked for (Rowlingson, 1994).

Sometimes, collectors would trade on their friendly relationships by telling customers that if they did not borrow more money then they (the collectors) would lose income:

'The woman [the collector] is too sympathetic and friendly; you don't like saying no to further loans.' (Jones 2002)

'When I'd finished the woman begged me to take out another loan. They sent me letter after letter to take out another loan.' (Jones 2002)

Collectors also occasionally told a customer that if they ever stopped borrowing then it might be difficult to start again. This meant that customers tended to maintain their loans with a lender even during times when they did not feel they needed one. Jones (2002) argues that customers can become trapped into a cycle of indebtedness in which they continue to struggle to repay loans but cannot, or feel reluctant, to end their links with home credit for fear of losing all access to future credit.

'This person had several loans with one company. She was paying £100 a week to a door-to-door collector. But she was terrified of stopping all loans… She couldn't get credit anywhere else.' (Jones 2002)

Among those who did not use home credit, the fear of getting into a cycle of borrowing was very much in their minds.

'…I've watched things, you know, programmes on TV, and how people have been in such a mess because they've borrowed off them.' (Kempson et al 1994)

Top-up loans

Some home collected credit companies encourage customers to take out top-up loans, whereby money owed on an old loan will be repaid with a new loan, giving customers less in their hand than the value of the new loan. This has been criticised for being an even more expensive form of borrowing than the usual loans from weekly credit providers, as customers can incur an early settlement fee on their existing loan.

Obligation to pay

The friendly nature of the relationship between collectors and customers also meant that customers felt an obligation to pay the collector even if it was a struggle to do so and it might mean they would be unable to pay regular household bills.

'We wouldn't like to miss him because he has been good with us, you know, we like to pay him up and that.' (Rowlingson 1994)

The timing of the visit (often to coincide with pay day or benefit day) meant that customers might lose a significant amount of money at an early stage in the weekly/monthly budgeting cycle, leaving them with very little by the end of that cycle.

'I think, 'how am I going to manage til next week now? You sort of have to borrow to manage to next week, and then next week you pay it back and you ain't got enough to last you the week so you've got to borrow again, and it's just like a vicious circle.' (Kempson et al 1994)

Where customers were particularly friendly with collectors they were sometimes concerned about reducing the collector's own income, as it was tied to the amount collected.

As we note above, home credit companies tend to be sympathetic about re-scheduling repayments they also take few people to court for non-payment. Their use of other forms of debt collection, however, did cause people anxiety.

> *'They don't care if you fall behind with your payments but in the end they start coming around in twos to persuade you.'* (Kempson et al 1994)

Home collection

Although users generally welcomed home collection, a recent study of pawnbroking found that some people disliked the idea of using home credit because they did not want collectors coming to their door every week (Collard and Kempson 2003).

This was partly a concern that such visits might involve *'sending the heavies round.'* But there were more general dislikes of being visited at home by a credit provider.

> *'I've never done it because you get so you can't open the door.'* (Collard and Kempson 2003)

4 Pawnbroking

Pawnbroking customers were generally people on low or modest incomes who pledged items of jewellery in order to buy necessities. The sums of money they borrowed tended to be small – usually no more than £100. Some, however, borrowed to cover occasional or 'lumpy' household expenditure, such as large quarterly bills, school trips, or Christmas or birthday presents. A small number used a pawnbroker like a safe deposit box – they kept renewing their pledges because they felt their valuables were safer there than at home.

The attractions of using a pawnbroker

The main attraction of pawnbroking was that it offered a quick and easy way of obtaining cash loans, without the need for lengthy application forms or credit checks. It also offered some flexibility in relation to repayment. In addition, pawnbroking customers welcomed the high level of customer service provided by members of staff, who they frequently described as friendly and helpful.

Accessibility

Compared with most types of high street credit, taking out a loan with a pawnbroker was quick and easy. There were no lengthy or complex application forms, no interviews and no credit checks. Customers simply had to have something of value worth pledging, usually jewellery. Most pawnbrokers also required customers to provide some form of identification. If they had both these things, customers could obtain a loan there and then. Indeed, people talked about being able to obtain '*instant money*' or '*fast cash*'.

Repayment

Pawnbrokers generally offer some flexibility in the way that loans can be repaid. A loan can be paid back in full at any time within the six-month contract, without any additional charge for early settlement. Alternatively, it can be renewed for a further six months upon payment of the interest accrued to date. If a customer cannot afford to redeem or renew the items they have pledged, the pawnbroker can sell the property to recoup the amount owed, thereby clearing the debt in most cases.

The drawbacks

In order to borrow from a pawnbroker, you first have to have something worth pledging. Many people living on a low income simply have nothing of value that they can use as collateral. Among those who do, the high cost of borrowing, the low loan-to-value rate, not being able to repay the loan in instalments, the risk of losing one's valuables, and the problems of losing a pawn-receipt were all cited as drawbacks of using a pawnbroker.

Cost

Like other lenders in the alternative credit market, pawnbroking companies have been criticised for the high interest rates they charge, particularly given the fact that the loans they make are secured on customers' property.

A recent study, however, indicated that most customers felt that the amounts they had to repay on their loans were reasonable, and very few of them considered cost to be a disadvantage of using a pawnbroker (Collard and Kempson, 2003). The rest felt that it was expensive to borrow money in this way and, not surprisingly, nearly all of them cited cost as a disadvantage of using a pawnbroker.

Loan-to-value rate

Another disadvantage of borrowing from a pawnbroker is that companies typically make loans that are only between a quarter and half the value of the item being pledged. As a result, if a customer cannot afford to redeem their valuables, they can lose a great deal more than the value of the loan. If a loan is for more than £75 the pawnbroker must (under the Consumer Credit Act) obtain the true market value of the un-redeemed goods they sell and return that sum less the original loan and any charges to the customer. These requirements do not, however, extend to loans of less than £75.

> *Some of them are right cons, they don't give you much for your stuff, they rob you. I've lost stuff in the pawn because I couldn't go back for it. I mean I take silly money and lose it. If something is valued at £200 and you borrow £50 on it, you've lost £200 if you can't claim it.* (Kempson et al, 1994)

A customer who pledges and redeems property on a regular basis will, however, generally be offered a better rate than a new customer or one who has defaulted on a loan. Regular customers may even be able to borrow more than the loan value of their goods.

Repayment

Some customers thought that having to repay the loan and interest as a lump sum at the end of the agreement in order to redeem their property was a drawback

> *You can't go in there with a bit each week or month. You have to have it all in one lump sum.* (Collard and Kempson, 2003)

A small number had repeatedly renewed their pledges over a considerable period of time, because they could not afford to redeem their valuables. Ironically, as one of them acknowledged, they had all probably paid back their loans several times over in the course of renewing their agreements.

> *… every time the six months comes up, I can't afford to do it, so I end up paying… I've just constantly been paying [company] for looking after it basically. I've paid back in interest now about three times what I've actually borrowed.* (Collard and Kempson, 2003)

Because of difficulties repaying what they owed, some of these people said they would prefer to repay their loan in instalments to spread the cost of redeeming their property, much as they would repay a loan from a home credit company. Some pawnbroking companies do allow customers to 'pay down' their loans in this way, particularly if they are having difficulty redeeming their property.

Loss of property

If a customer does not redeem or renew an agreement at the end of the six-month loan period, the pawnbroker is entitled to use the property to recoup the loan, interest and any associated costs. Customers were anxious to avoid this happening because as well as providing collateral for loans, the items they pledged often had strong sentimental value. Some people had, however, lost their valuables because they could not afford to redeem them or renew the contract.

Loss of pawn-receipt

The pawn-receipt is a vital document. It provides proof of ownership, and without it the customer (or their authorised representative) cannot redeem their goods.

Under the terms of the standard pawnbroking agreement, it is the duty of the customer to notify the pawnbroker in writing of the loss or theft of a pawn-receipt, to prevent the items being redeemed by an unauthorised person. In order to redeem the property, the rightful owner must then sign a statement to say that they have lost the pawn-receipt. The small number of customers who had ever lost their pawn-receipts generally considered these procedures to be a rigmarole.

5 Social Fund Budgeting Loans

Social Fund Budgeting Loans are the latest in a series of government measures to meet the lump sum needs which people on Income Support, Income-based Jobseekers' Allowance or Pension Credit may be unable to cover out of their income. Budgeting Loans are interest-free and deducted at source from benefits and, following changes to the scheme in 1999, are no longer linked to a specific need. Instead, decisions are made according to fact-based criteria rather than on a discretionary basis. People generally apply to the scheme for essential items such as furniture, beds and bedding, and white goods.

The attractions of the Budgeting Loan scheme

The main attraction of Budgeting Loans is that they are interest-free. In addition, the application form is relatively straightforward to complete and decisions are made fairly promptly about whether or not a loan will be awarded. Loan repayments are deducted directly from benefits, minimising the risk of falling into arrears.

Interest-free loans

Budgeting Loans are the only source of borrowing available to people on low incomes that does not incur interest charges. For applicants whose only alternative would be to borrow from a high-cost lender or else go without, this was the main advantage of the scheme.

As a consequence, they were often the first port of call for benefit recipients who needed to buy 'lumpy' household items but had few, if any, options to raise the money they required.

> *I think it's very helpful for people like myself who haven't been in regular employment and can't get loans any other way… If I hadn't taken out the Social Fund loan I don't know where I would have got the money from to get certain things, my washing machine and essentials we need.* (Whyley et al, 2000)

Application process

Recent changes to the Budgeting Loan scheme meant that people now found the application form simpler and easier to fill in. The fact that eligible benefit recipients did not have to apply for a Budgeting Loan in person was seen as an advantage for older people and those with health problems. Instead, they could request an application form by telephone and return the completed form by post. Applicants also felt that the decision-making process was quicker than it had been previously, with most receiving a response to their application within seven to 14 days. Finally, one woman liked the idea of having more than one loan offer, so that applicants could choose the most affordable option (Whyley et al, 2000).

Repayment method

The direct deduction of Budgeting Loan repayments from benefits proved very popular with users of the scheme (Whyley et al, 2000). They generally adjusted to managing on less money and, because the repayments were deducted before they received their benefits, they were not tempted to spend it. As a result, they did not have to worry about falling behind with the repayments.

> *I think in a way it is a good thing, because it is coming straight off your money, so you are not having to remember to pay it every week… if it didn't come off your Income Support and you had to pay them direct, you could forget or not bother, say 'I will miss it this week', then you have got double to pay the following week, so I think it is better.* (Whyley et al, 2000)

The drawbacks

The Budgeting Loan scheme has a number of important limitations. In terms of access, it is only available to people who have been in receipt of Income Support or income-based Jobseeker's Allowance for at least 26 weeks. Use of Budgeting Loans is further limited by lack of knowledge among eligible benefit recipients, as well as lack of understanding about the rules governing the scheme and how decisions are reached.

Moreover, because the scheme is cash-limited, applying for a Budgeting Loan is something of a lottery - a quarter of Budgeting Loan applications were turned down in 2002/2003 (Department for Work and Pensions, 2003). Even if an award is made, applicants often do not receive the full amount of money they requested. Finally, many users of the scheme are critical of the high repayment rates set for Budgeting Loans. Other complaints about the scheme included the length of the application form and the intrusive nature of some of the questions and the fact that some members of staff were unhelpful.

Eligibility criteria

In its current form, the Budgeting Loan scheme is only available to people who have been in receipt of Income Support or income-based Jobseeker's Allowance for at least 26 weeks. Consequently, people who have only recently made a claim for these benefits are excluded from the scheme and may face considerable hardship as a result (Barton, 2002). In 2002/2003, eight per cent of Budgeting Loan applications were turned down because applicants had been in receipt of a qualifying benefit for less than 26 weeks. A further four per cent were refused because they were not on a qualifying benefit at all (Department for Work and Pensions, 2003).

Even among eligible benefit recipients, use of Budgeting Loans was limited by lack of knowledge about the Social Fund. Some people had no idea that this type of financial assistance was available through the benefits system (Whyley et al, 2000; Kempson et al, 2002). Others objected on principle to the provision of Budgeting Loans for people on low incomes – they either felt that benefit rates should be substantially increased to enable people to afford 'lumpy' items of expenditure, or that there should be more grants available (Kempson et al, 1994).

Rules of the scheme

On the whole, applicants found the rules governing the Budgeting Loan scheme difficult to fathom. This related to the items and sums of money they could apply for, as well as the decision-making process.

Budgeting Loans are only awarded for certain expenses[1], and this limited the usefulness of the scheme from some applicants' point of view (Whyley et al, 2000; Kempson et al, 2002). Moreover, they did not understand why this restriction was necessary, when the money they borrowed would be repaid. In addition, although they knew that the maximum amount they could borrow was £1,000, they had very little idea of their own 'credit limit' when they made an application or how this was determined. This made it difficult for them to use the scheme effectively (Whyley et al, 2000; Jones, 2002).

The decision whether or not to award a Budgeting Loan is determined by two factors. The first is the weighting given to each application, which is based upon a set of criteria relating to the personal circumstances of the applicant; the second is the district budget. The amount that applicants can borrow also depends on whether or not they already have an outstanding Budgeting Loan.

It was clear that people had little idea about how decisions were made in relation to Budgeting Loan applications. In particular, they were uncertain about the impact of existing Social Fund loans on their chances of success (Whyley et al, 2000; Jones, 2002). Indeed, the most common reason for loan applications to be turned down in 2002/2003 was outstanding Social Fund debt (Department for Work and Pensions, 2003).

Outcomes

The cash-limited nature of the Social Fund, combined with the complex rules governing it, made applying for a Budgeting Loan something of a lottery. Applicants could not be certain that they would be awarded a Budgeting Loan, and felt that decision-making was unfair and inconsistent - the needs and circumstances of those who received Budgeting Loans often appeared to be no different to those who were turned down (Whyley et al, 2000; Jones, 2002; Kempson et al, 2002).

Even if applicants were offered a Budgeting Loan, it was often for less than the amount they originally applied for, leaving them to make up the shortfall in some other way. Some people intentionally applied for more money than they needed, knowing that they would not receive the full sum (Whyley et al, 2000; Kempson et al, 2002).

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[1] To buy furniture or household equipment; to buy clothing and footwear; to pay rent in advance, and/or removal expenses; to pay for home improvements, maintenance or security; to help meet travelling expenses; to pay for things to help people move into work; to repay HP or other debts.

Barton (2002) also notes that very low maximum amounts are available for people without children because of the weighting system used.

Levels of repayment

Published guidance on the Social Fund indicates that there are three rates of repayment that normally apply: 15 per cent, 10 per cent and five per cent of benefit payments. Repayments are normally 15 per cent of the applicable benefit amount (excluding housing costs) where the applicant has no other credit commitments or arrears to be repaid. If the applicant has other direct deductions made from their benefit, for example for rent or fuel arrears, the repayment rate may be lowered to 10 per cent. If these direct deductions are high, the rate of repayment could be reduced to five per cent.

As with other aspects of the scheme, there was a widespread lack of understanding about how repayment levels were set (Whyley et al, 2000; Kempson et al, 2002). In particular, people did not understand why the repayment rate was higher on smaller loans.

> *The only thing I don't understand with the Social is the smaller the loan they give you, the more money they take back… let's say I had a £800 loan, they would take, from experience, they would take about £7, £8. If you get a £50, £60 loan, they'll take like £13, £14 a week. Maybe it's to clear it up quicker.* (Whyley et al, 2000)

But criticism centred on the high levels of repayment for Budgeting Loans (Kempson et al, 1994; Whyley et al, 2000; Barton, 2002; Jones, 2002; Kempson et al, 2002). Some people had in fact declined Budgeting Loans because of the weekly amount they would have to repay. Others accepted despite the high repayment rate and struggled to make ends meet as a result. This had discouraged a number of people from using the scheme again. Moreover, direct deduction of repayments could mean that their Budgeting Loan was paid back at the expense of other priority creditors.

Applicants can ask for the repayment rate to be lowered if they experience financial difficulties repaying their Budgeting Loan. In practice, few do. Users of the scheme generally said they would prefer to have a smaller amount deducted from their benefits over a longer period of time, and for more account to be taken of their personal circumstances (Whyley et al, 2000; Kempson et al, 2002).

Other points

Previous research has found that Pakistani and Bangladeshi people make little use of the Social Fund because they felt it signalled to others that they were unable to manage (Herbert and Kempson, 1996). This was part and parcel of a general reluctance to claim social security more generally.

6 Credit unions

Community credit unions have two main objectives: to promote saving and provide access to low-cost credit, with members' savings being used as security. Members must typically save for a set period of time (usually 3-4 months) before they become eligible for a loan; they can then borrow a set multiple of their savings. In smaller, newer credit unions members can borrow double the amount they have saved; in larger, more established ones the multiples are greater – usually up three or four times savings. Regularity of saving is also taken into account when a member applies for a loan and savings cannot be withdrawn while they are providing security for a loan. Interest rates on credit union loans are just 1% per month. A small number of credit unions have been experimenting with 'instant access' loans, available to people with no previous history of saving.

Credit unions have, however, been slow to develop in Britain. Currently, there are around 700 registered credit unions with a total of 325,000 members. Just over half of these (378) are fairly small community-based credit unions where membership is based on residence, and a further 110 are open to people who either live or work in the area covered by the credit union. There are also around 100 employment-based credit unions that tend to be larger and to have greater assets. The remaining 103 credit unions are run through associations such as churches (Registry of Friendly Societies, 2002).

The attractions of credit unions

The three main attractions of credit unions are that they provide access to credit for people who would not be able to borrow from a high street credit company; they are low cost; and they are willing to reschedule repayments if a borrower encounters financial difficulties. Other attractions include affordable payments, the friendliness of credit unions and the fact that they are local.

Access

Low-income members of credit unions commented on the fact that, provided they are able to save, they offer access even to people who have impaired credit histories or whose characteristics mean that they would find it difficult to get credit from high street providers (Whyley et al, 2000). New members are not subject to credit checks, although they are asked to provide the name and address of someone who will vouch for them. Beyond that, as noted above, access to loans is determined by their own saving.

Members found it easy to provide suitable proof of identity and the application process for most loans straightforward. A minority of members commented that the way that credit limits are set meant that it was easy to calculate how much they would be eligible to borrow.

Low cost

Members particularly valued credit unions because they provide access to low-cost credit. Their charges are a good deal lower than any commercial provider – although cheaper credit can be obtained from some other savings and loans schemes and, of course, through interest-free loans from the Social Fund. Non-members who knew anything at all about credit unions were generally aware of the low charges (Jones, 2002).

Payment re-scheduling

The third key advantage of loans from a credit union is the fact that, if a borrower is having financial difficulties, they receive a sympathetic hearing and repayments can usually be re-negotiated – in fact, as many people mentioned this as commented on the low cost of loans (Whyley et al, 2000).

> *Say I missed a week's payment, well you wouldn't get hassles over it.*

As a consequence, people felt able to contact the credit union before their problems got out of hand. If their problems were temporary they were encouraged to pay what they could afford during this time and then revert to their normal repayment level. People with longer-term difficulties generally had their repayments reduced to a level they could afford. In both cases the term of the loan was extended, without incurring any additional charges.

Affordable payments

A number of credit union members said that they had been actively involved in setting the repayment levels on their loans and that they were encouraged to agree repayments that they knew they could afford (Whyley et al, 2000).

> *Well the advantage is, you will always have a say in what you are going to repay… the credit union will speak to you about your loan repayments.*

Linked to this is the fact that credit union loans can be repaid early, either as a lump sum or through a series of higher repayment, without incurring early settlement fees. Several people liked the fact that they could do this, although none was, apparently, aware that commercial creditors would be likely to charge them a fee.

The fact that loans could be repaid weekly was an added bonus (Jones, 2002).

A friendly, local service

Several people commented on the friendliness and helpfulness of credit union staff; others that they joined because it was local and convenient to get to. This is in contrast to high-street providers who generally have no presence at all in low-income communities.

Indeed, research on tackling financial exclusion has identified a high degree of disengagement from mainstream financial services among people who live long-term on low incomes. Local providers were seen as important as people felt that they would understand better the circumstances of people in their circumstances (Collard et al, 2001; Kempson and Whyley, 1999).

Other attractions

Credit unions appealed to people for a number of other reasons as well. These included: the advantage of having savings to act as security – just in case one needed it; the fact that credit unions insure loans, in case of death; and the fact that a loan has to be cleared before another can be requested – which acts as a curb on borrowing.

The drawbacks

A key drawback of credit unions is, of course, their limited availability, so that many people on low incomes do not have one in their vicinity. Indeed, people had had to let their membership lapse when they moved out of the catchment area for their credit union. Moreover, several studies have identified low levels of knowledge of credit unions even in communities where they are active. Some people were totally unaware of the credit union; others had heard of it, but did not know what it was, where it was located or how it operated (Jones, 2000; Rowlingson, 1994; Whyley et al, 2000).

But while these factors act to limit use of credit unions they are not necessarily structural. Certainly the way that community credit unions are normally run in Britain – relying on committed volunteers and adopting a 'bottom-up' approach to development – does limit the ease with which they can be set up in some communities and has been a constraint on the growth of the network. But reliance on volunteers is not universal. Workplace credit unions are often run by employers and some community credit unions are operated by churches or other bodies. Moreover, other savings and loans schemes have been set up and run by housing associations – for example, the *New Horizons* scheme operated by Cambridge Housing Association and Cambridge Building Society and *Helping Hands*, run by Darlington Building Society with a consortium of local housing providers.

There are, however, a number of drawbacks, many of which are related to the link between saving and borrowing.

Link between saving and borrowing

The link between saving and borrowing acted as a drawback for both members of credit unions and those who had decided not to join.

It deterred people from joining a credit union in the first place – as either they could not commit to saving regularly at all, or they believed that they would be unable to save *enough* money to be able to borrow the sort of sums they normally needed (Kempson et al, 1994). Experience of others bore this out. One woman, for example, had only managed to save £20 when she was a member of her local credit union and her saving had been sporadic - so she was never able to get a loan. She described her experience as:

> *… not too good… [I was] not in it long enough to get a loan… not earning enough to put in each week.* (Kempson et al, 1994)

To get round this difficulty, the children of an elderly woman had opened an account for her with a credit union. Between them, they regularly put money in the account on her behalf. She was, however, worried that one of them might lose their job and need to withdraw their savings.

Wait for first loan
It is custom and practice for new members to have to establish a savings record in the credit union, to show their credit-worthiness, before they can apply for a loan. This was a real difficulty for some people.

> *But if you do need the money, you cannot afford to save for 12 or 13 weeks, you need to borrow there and then. In a credit union you have got to have money in already to borrow.*

Consequently, they decided against joining (Jones, 2002).

A rather disenchanted credit union member said that she had had to wait four months for her first loan. This, together with the need to go before the loans committee (see below), had persuaded her that a credit union was, in fact *'no better than other forms of credit'* (Whyley et al, 2000).

Regularity of saving
The most commonly mentioned drawback among credit union members on low-incomes was that the regularity of their saving was taken into account when they applied for a loan. Some had been unable to borrow as much money as they had requested because of a broken saving record; a minority had not been able to borrow at all. All were conscious of this need for regular saving, but often found it difficult to save every week. If they missed a weekly deposit they felt obliged to make it up as soon as possible so that they did not impair their access to loans in future.

One loan at a time
A number of credit union members also commented that once they had a loan, they could not take out another until it was repaid, although they could top it up to the amount they had borrowed originally.

Access to savings
Finally, a minority of people had needed to withdraw some of their savings while they were repaying a loan, and had not been able to do so. In one case, a lone parent had had her car wheel-clamped and needed access to her savings so that she could get her car out of the car pound as it was the only money she had put by. She was angry when she was told that the savings were needed as security for her loan (Whyley et al, 2000).

Serves a clique

We noted above that members often saw the friendliness of their local credit union as an attraction and that some did not want it to grow in case this was jeopardised. The reverse of this is that other people felt that their local credit union was '*run by a clique*' for their own benefit. One study found that there was 'a strong perception that credit unions serve a preferential group of people and were not open to everyone' (Jones, 2002). Indeed, the same study also found credit union members who were inclined to this point of view.

> *If your face fits… you know what I mean. I've been in it since it opened, I have some money in it and I can get a loan because I am known. But other people couldn't.*

Other people had been unable to join the local credit union because they did not know anyone who was already a member who could act as a referee.

> *You've got to have a member speak for you, that's the problem. I don't know anyone in the credit union.*

Run by volunteers

We noted above that the reliance on volunteers often restricts the development of credit unions, because suitable people do not come forward. But the use of volunteers also acts as a drawback in two other ways.

First, three separate research studies have found that people were deterred from joining a credit union because of a perceived lack of confidentiality (Jones, 2002; Kempson and Jones, 2000; Rowlingson, 1994). When they apply for a loan, applicants need to disclose information about their personal finances and, in particular, their ability to repay a loan. They feared that volunteers might 'gossip' about them and, in some cases, cited instances where this had happened.

> *One of the volunteers… was unfortunately very well-known [locally] and knew everybody and knew everything about everybody and wasn't averse to telling… This person signed [a confidentiality agreement] and he wasn't averse to saying who's got what.* (Kempson and Jones, 2000)

> *This girl went into a shop and the girl from the credit union was there and she asked her about her loan, she felt embarrassed.* (Jones, 2002)

Secondly, there was a perception among non-members that volunteers would be incapable of running a professional organisation, especially if there were few or no paid staff (Jones, 2002). On occasion, this concern was borne out by the experience of credit union members. Three disenchanted members commented that their credit union was badly run, with only minimal systems in place and volunteers who were sometimes disorganised (Whyley et al, 2000).

Having to go before a committee for larger loans

While most members found applying for a loan straightforward, those who had needed larger amounts commented adversely on the need to put their case in person to a loan committee (Whyley et al, 2000). This caused them embarrassment and they felt it was demeaning. It fuelled the disenchantment already felt by two members – both of whom were thinking of leaving the credit union.

Method of payment for those without a bank account

A minority of members on Income Support commented on loan repayment methods – which tend to be made in person at the credit union (Whyley et al, 2000). Some larger credit unions can accept payments by standing order, but a high proportion of people on low incomes do not have a bank account.

One woman who suffered from agoraphobia found it difficult to make her loan payments in person, as did others who did not live near the credit union collection point. Others were worried that they might forget to make the payments or, worse still, be tempted to dip into the money for other purposes.

Previous research has identified a preference for either doorstep collection of payments (Jones, 2002) or for direct deduction from social security payments (Whyley et al, 2000).

No interest on savings

Interest is not paid on money saved with a credit union, although members may get a dividend payment if finances permit. Although most credit union members saw the dividend they got on their savings as a bonus, a minority were contemplating leaving their credit union because of the poor return on their savings (Whyley et al, 2000). One married woman in her late fifties had never received even a dividend and saw the £1,600 she had saved with the credit union as 'dead money'. While a retired woman only planned to continue saving with the credit union until she had £500. She then intended transferring the money to a building society account instead.

Other drawbacks

Individuals also mentioned several other drawbacks, although most of these were particular to their own credit union rather than a general criticism. One woman had had 'a bad experience' when someone she had introduced to the credit union defaulted on their loan repayments. Another had been made to feel embarrassed when she had been unable to keep up with her own repayments and, unlike others, had not found the credit union staff particularly sympathetic. And a man who had gone into the credit union to withdraw some of his savings was told he would have to wait a week for his money as they did not have the cash available. He was furious because he had joined the credit union to save and had never taken out a loan. All three incidents were almost certainly caused by bad practice locally (Whyley et al, 2000).

7 Other credit sources

Other forms of credit use were less common among low-income consumers and included sale and buy back, rental purchase, pay day loans, informal savings and loans schemes, and borrowing from unlicensed moneylenders.

Sale and buy back

In Britain, sale and buy back is provided by companies such as Cash Convertors and Cash Generators. A customer sells an item, such as a CD player or food mixer, to the shop for cash but has the option of buying it back within 28 days at a higher cost. The customer can retain the option of buying back their goods for another 28 days if they pay the difference between the sale and buyback price. If they do not buy back their property, it is put on sale in the shop.

The only attraction of sale and buy back for low-income consumers was that it offered a ready source of cash. In addition, sale and buy back shops generally accepted a wider range of items than a pawnbroker.

People who had borrowed money in this way felt that the main drawbacks were the low loan-to-value rate that sale and buy back shops typically offered and the relatively short period of time they had to buy back their goods before they were sold. The cost of buying property back was another disadvantage.

> *You have to get it out in a month. It can result in people losing things that they have paid a lot for… I put in a hi-fi and got £80 for it, a month later I got it back for £105. £80 was only a fifth of the worth of it.* (Jones, 2002)
>
> *They tend to give you, like, stupid prices… Just unrealistic. My mate had a set of golf clubs and… and it cost them like £180 and he took them dwon there and they offered bugger all, £30, they were quite new.* (Whyley et al, 2000).

Finally, unlike pawnbroking, sale and buy back is not a credit agreement and therefore customers are not covered by the Consumer Credit Act.

Rental purchase

The main provider of rental purchase in Britain is Brighthouse, formerly called Crazy Georges. Customers can buy furniture, white goods and other household items by paying regular instalments to the shop; the company also offers optional damage liability insurance and service cover. As well as allowing customers to spread the cost of buying 'lumpy' goods, there are no credit checks. All customers have to do is provide the name, address and telephone number of five people who can confirm that they know the customer and verify their address. In addition, many people were attracted by the premises and the fact that the company was perceived to sell good quality items (Jones, 2002).

Despite the appeal of rental purchase, for most people the disadvantages far outweighed the advantages. Goods bought on rental purchase can be repossessed at any time until a third of the repayments have been made, and this was the chief drawback from the customer's point of view.

> *You've only got to miss one payment and they come and take the stuff back.* (Whyley et al, 2000).

> *They've got no qualms. If you can't make that payment that week, they come out and take it off you.* (Whyley et al, 2000).

Some people also felt that the stringent debt recovery policies followed by the company verged on harassment.

> *If you don't pay, they hound the references to get at you, they send the heavies out if you don't pay, to repossess the item, they send them out at 9 o'clock at night in the van knocking at your door.* (Jones, 2002)

Another disadvantage was cost. Goods sold on rental purchase are more expensive than those sold in other high street shops. In addition, rental purchase customers were strongly encouraged to take out the 'optional' insurances and service cover which, on top of the interest charged, increased the total cost even more (Jones, 2002).

Pay day loans

A growing number of cheque cashers, pawnbokers and home credit companies are offering pay day loans. Customers write one or more cheques to the company that, in return for a fee, agrees not to present the cheque for up to 30 days. They receive the amount of the cheque, less the fee. At the end of that time, customers can settle in cash, let the cheque(s) be presented to their bank or extend the period before the cheque is presented by a further 30 days by writing another cheque and paying another fee. To access this form of credit, one needs to have a bank account with a cheque book and also to have a regular income going into it – normally from paid employment.

As a consequence, pay day loans tend to be used by people who are in either skilled manual or junior white collar jobs, who have incomes that are just below the national average. Often these people are already at their credit limit on overdrafts and credit cards. They are not used to any great extent by people on low incomes (Dominy and Kempson, 2003).

Their main attraction is the easy access they offer to cash loans. Users often contrasted this with the difficulty and questioning they encountered trying to increase the credit limit on their overdraft or credit card (Dominy and Kempson, 2003).

> *The simplicity of it and how quickly you can get the cash. You don't have to go in with an explanation or anything. Whereas if I was going to the bank for a loan or an overdraft, I'd have to go and sit and explain and take my figures with me.*

They were also seen as cheaper than exceeding these credit limits without authorisation. Moreover, the charges were known in advance (Dominy and Kempson, 2003).

> *I mean the amount of charges I get whacked on through my bank, slyly… You get £25 whacked on here and there for trying to overdraw, or whatever, and things not clearing.*

Some people also felt that they provided more control over spending than these forms of running account credit (Dominy and Kempson, 2003).

The chief drawback of pay day loans is the high fees charged – ranging from £6 to £14 for a £100 cheque held for 30 days and between £2 and £7.50 for a £50 cheque retained for 14 days (Dominy and Kempson, 2003).

In addition, some people disliked the very thing that had attracted them in the first place – namely the ease of access. They felt that it was too easy to get into a situation where they regularly borrowed at the end of each month or their cheques were constantly extended through lack of money (Dominy and Kempson, 2003).

> *Well, I've kind of dug myself into a hole and I'm trying to get out of it. You sort of rely on it. When my wages go through, my wages pay it… My wages are between a thousand and twelve hundred a month. So if I'm borrowing £500, that's half my wages near enough gone. So I get to the end of the month again and I need some funds to tide me over.*

Most companies do, however, set a limit on the number of times a cheque can be extended. Often people borrowed from other sources to settle the account when they had reached this limit.

Credit cards

In recent years, companies have begun offering credit cards in the sub-prime market. For the most part, though, they seem to target people with impaired credit histories rather than those with very low incomes.

Although they have much higher interest rates than other credit cards, they are still much lower than any of the other forms of non-mainstream credit. Against this, there is a very real fear among people on low incomes of the temptation of over-spending on credit cards. They also feared unexpected charges if they missed a payment (Collard and Kempson, 2003; Jones, 2002; Kempson et al, 1994; Whyley et al, 2000).

Provident Financial, the biggest home collected credit company, has recently launched a new form of 'credit card' that can be used at Argos stores. This differs markedly from other cards in that it does not offer running account credit – instead it is more of a stored value card that is bought on credit and repaid in weekly instalments. Indeed, it might be argued that this is a plastic card (and therefore more 'modern') equivalent of the 'cheques' that used to be sold by Provident. It is, however, too early to gauge reactions to this card from independent research.

Informal savings and loans schemes

Informal savings and loan schemes are commonplace in many ethnic minority communities, where they have a variety of names including ‘Partners’ ‘Sou Sous’ or ‘Boxes’ in African Caribbean communities, ‘Kommittis’ in Pakistani communities ‘Kameti’ ‘Kuri’ or Chitti’ in Indian communities and ‘Hui’ among Britian’s Chineses communities (Herbert and Kempson, 1996; Kempson, 1998). Typically they are based on a group of friends, relatives or work associates who save collectively and take it in turn to have access to the money saved. New members are screened for their trustworthiness and ability to save. They usually have about 10-30 members who each pledge to save the same set amount – say £10 a week. The money is collected by a ‘banker’ when members meet and these bankers are usually someone of standing and known integrity. Members usually receive the total amount saved in any one particular week in rotation – in some cases the order is determined by the length of time someone has been a member although it can also be decided in advance by drawing names out of a hat.

Similar schemes also exist in some white British communities – in Liverpool, for example, they are known as ‘Tonnies’ or ‘Tontines’ (Jones, 2002). These are, however, primarily savings clubs with the money being paid out at an agreed date – often Christmas. Members can, however, apply for a loan and sometimes this carries interest.

> *You can borrow in ours. It’s £15 on £100. It’s supposed to be a savings club, but they let you borrow from it.* (Jones, 2002).

People are attracted to such schemes because they are an old established form of credit, and seen as far more accessible than commercial credit. For the most part loans are also interest free.

> *I think a lot of us do this because of the credit situation. And it’s among ourselves. It’s the best way… I think so any way… you don’t have to pay no interest.* (Kempson, 1998).

Among Muslims they have the added attraction of complying with Islamic teaching.

They are also attractive because they offer members the opportunity to meet socially.

> *We have 14 members, only women. It’s good, gives us a chance to have a natter, gossip and general get together.* (Kempson, 1998).

But they are not without their drawbacks. First, their very informality means that members run the risk that people early in the list for the collective savings cease to save once they have got the money. This acted as a deterrent to use.

> *I am not sure about the legality of the Partner. I am afraid that I will not get my money back when it is my turn. I have heard stories about people who did not get their money.* (Herbert and Kempson, 1996).

Some people had, in fact, lost out in this way and had no means of redress.

I used the Partner in the past. I used to contribute £20 per week, but when it came to my turn to collect, I had difficulties getting my 'hand'. I would use it again, but only if done properly (Kempson, 1998)

Secondly, the amounts to be saved can act as a deterrent. In some cases the set level of weekly saving is beyond the means of people on low incomes. This is particularly the case in Pakistani communities, where Kommitti members are often working and can save quite large amounts (Herbert and Kempson, 1996; Kempson, 1998). On the other hand, Somali refugees found that the amounts that they could afford to save in their small group did not amount to very much even when added together (Collard et al, 2001).

Unlicensed moneylenders

Unlicensed lending is prevalent in poor communities. The image conjured up by the term loan shark tends to be one of an aggressive male 'heavy', but unlicensed lenders also include local women who lend small amounts of money for a short period of time to the people living around them (Jones, 2002).

People invariably considered borrowing from an unlicensed lender to be the very last resort for someone who desperately needed cash (Whyley et al, 2000; Collard et al, 2002; Jones, 2002). The fact that a request for a loan was never turned down was its only attraction. The cost of borrowing in this way was incredibly high and it was common practice for lenders to take people's benefit books as security. The lender would then wait outside the post office every week while the debtor collected their benefit, and take the repayment they were owed. This could be as much as 75 per cent of the debtor's benefits.

In addition, there was evidence of lenders using intimidation and physical violence if debtors were late with their repayments or had difficulty repaying what they owed.

You have got to pay back, straightaway, it's high interest but they might come and break your arms. (Jones, 2002).

I know someone who went to a loan shark and because they couldn't afford to pay it, like, they've got about seven kids, they went to the house and they beat the dad up in front of the kids. (Whyley et al, 2000).

8 Overview of key attributes of an affordable source of credit

It is possible to identify a number of underlying themes from the above critique of specific sources of credit. First, people on low incomes want to be fairly certain before they apply that they are likely to get the money they need. Secondly, they are generally as concerned about minimising the risk of default as most lenders. They are, therefore, attracted to sources of credit that enable them to manage the higher than average risk that they face and also help them retain financial control. Thirdly, they look for flexibility. They appreciate lenders who recognise the difficulty of maintaining regular payments and have systems in place to help people through cash flow crises. Finally, they prefer to deal with creditors who offer an approachable but professional service. They recognise that these requirements will, almost inevitably, come at a cost – but believe that they are often charged more than is justifiable and resent this.

Access

Without exception, people valued the ease of access offered by commercial credit sources such as home credit, pawnbroking, sale and buy back or rental purchase. They did not think that credit was a right or that it should be given without consideration to their ability to repay, but they did want to know *in advance* whether or not an application would be successful.

This meant that the criteria for assessing access needed to be simple and transparent – the Social Fund in particular was criticised for its complex rules regarding 'credit limits'. People also disliked intrusive questioning about their need for a loan. They accepted that they would need to demonstrate their ability to meet the repayments on a loan. They were also comfortable with providing names and addresses of people who could vouch for them. What they disliked was having to justify their wish to borrow for a particular purpose (as used to be the case with the Social Fund) or making their case to a committee of local people, as happens for larger loans from most credit unions.

Providing security for loans can help to reduce costs. But this could be problematic. Sale and buy back companies offered very little for the goods they bought relative to their value. And people sometimes pledged items with pawnbrokers that were a lot more valuable than the sum of money they wanted to borrow. As a consequence, they incurred a substantial financial loss if they could not afford to buy back or redeem their possessions.

Credit union loans are, on the whole, securitised by people's savings. So people have to save regularly for several months before they can borrow and even then the size of their loan is a fixed (and fairly small) multiple of their savings. This acted as a barrier to people who had lived on a low income for some time. Some credit unions have experimented with 'instant access' loans but, without a radical change in the funding of credit unions, the availability of these will be limited. A number of other drawbacks to the link between savings and loans have been identified through further analysis of interviews with credit union members. These included the way that regularity of saving determined both access to loans and the amounts they could borrow. Members also had limited access to their savings while a loan was being repaid. Credit unions were primarily seen by members as means of saving rather than borrowing and the loans they took out tended to be an 'advance on savings' and used to bring forward discretionary spending.

Repayments

On the whole, people on low incomes prefer to borrow small fixed sums of money that are repaid in fixed, affordable amounts. A series of small loans is much preferred to either one large one or, worst still, running account credit.

They welcome being actively involved in setting the terms of their loan so that they know that they will be able to meet the payments. They also appreciate weekly rather than monthly payments since that tends to be the period over which they budget. Credit unions were particularly praised for the way that borrowers are normally encouraged to decide what they can realistically afford before the amount and term of the loan is decided. In contrast, loans from the Social Fund were much criticised because the repayments tend to be set at 15 per cent of income and recouped over a much shorter period of time than is usual for loans from other creditors. A key drawback of pawnbrokers was the need to settle the loan in full at the end of the term. Many pawnbroking customers would have preferred to make regular weekly repayments.

Linked to this point is the matter of early settlement. Users of both credit unions and pawnbrokers liked the way that loans attracted monthly interest charges and could, as a consequence, be settled early without penalty and paying only the interest incurred to date. The law on early settlement is almost certain to be changed following the White Paper on consumer credit but currently people who borrow from home collected credit companies are frequently encouraged to take out 'top-up' loans – settling an existing loan from further money lent to them – with a fee charged for early settlement.

In particular, credit union members liked the fact that they could set up affordable levels of repayment while having the option of paying extra money when they could. This concept of 'flexible payments' is one that mortgage lenders now offer but is not common for consumer credit. It could, however, provide people with some protection should they be unable to meet their regular repayments.

The method of repayment was also important. Users of home credit and mail order customers liked having repayments collected from their home. People who borrowed from the Social Fund welcomed the deduction of repayments from their income. Both these repayment methods were popular because they helped minimise the risk of default. When money is tight, the temptation to dip into credit repayments is great. At the same time, lending in a high-risk market depends on having these controls in place. Indeed, it is interesting to note the way that many mainstream creditors are now adopting a 'holistic' approach to account and arrears management, which includes putting people at risk of default on direct debit or standing order payments (Dominy and Kempson, 2003b).

What people did not like about some home collection companies, however, was the practice among agents of routinely encouraging further borrowing. Indeed, both users and non-users made this criticism.

The question of credit insurance arose in two contexts. Credit unions provide insurance cover free of charge to repay loans in the event of a death and this was generally welcomed by members. Rental purchase companies, on the other hand, provide insurance to cover goods in case of fire, flood or theft. Although optional, in practice most people are persuaded to take out this cover as well as a warranty for the goods supplied. Customers of these companies complained that they were often given the impression that these additional features were compulsory. This greatly increased the cost of buying things on credit but (being optional) was not reflected in the APR of the loan.

Handling of financial difficulties

Life on a low income is a financial balancing act, especially among people of working age. As a consequence, most people who live on low incomes for long periods of time almost inevitably find it difficult to make ends meet from time to time. Many creditors are aware of this fact and have built in a degree of flexibility to the repayment schedule. Home credit and credit unions are both prepared to reschedule loans, extending the term by a week or so, in cases of financial difficulty. Mail order companies, too, are often prepared to be flexible over repayments. This was frequently cited as one of the main advantages of these forms of credit.

In contrast, although rescheduling of Social Fund loans is possible, it is not publicised and few people were aware of the possibility. Rental purchase companies were criticised for the fact that they were very quick to impose debt recovery and repossess goods when payments were missed. And with sale and buy back, the period goods are held cannot usually be extended.

The other important aspect to this is charges for default. On the whole, lenders that are prepared to reschedule do not levy additional charges for this (although it may be included in the total cost of credit). In contrast, rental purchase companies (and most mainstream lenders too) can have high charges for missed payments. This tends to exacerbate an already difficult situation for the borrower. As a consequence, users of home credit often say that they are prepared to pay the high charges up front as they know that there will not be any hidden costs. In other words, they are willing to pay for greater security and control.

Again, it is interesting to note that the trend towards a holistic approach in the mainstream credit market is bringing greater flexibility over repayments and avoidance of debt recovery in cases of genuine hardship (Dominy and Kempson, 2003b).

Provider

Previous research on overcoming financial exclusion has found that people want to deal with reputable companies who also have an understanding of the difficulties of managing on a low income (Kempson and Whyley, 1999; Collard et al, 2001).

People tended to be suspicious about the reputability of the commercial creditors in the alternative credit market if they had not used them before. This applied especially to the newer companies offering sale and buy back, rental purchase and pay day loans. But concerns were also expressed about pawnbrokers and home credit companies too. In part, this was due to a perceived stigma of using these forms of credit; in part, a fear of using an unknown company that might not be entirely reputable. On the whole, therefore, people selected their sources of credit following personal recommendation.

On the other hand, many long-term users of mail order catalogues, home credit companies and pawnbrokers valued the relationships they built up with their staff. In particular, they liked the fact that staff members were from the same social class as their customers. Some users of home credit, however, felt that these close relationships left them vulnerable to being persuaded to borrow more than they would have liked.

It was, however, credit unions that were most criticised in this regard. Even members commented on the fact that credit unions were not always run as professionally as they might be. They were uneasy about discussing their financial affairs with volunteers drawn from their community and, among non-members, this was often one of the main drawbacks. They were concerned that their savings may not be safe; they were worried that volunteers might (and in some cases did) gossip, and they often believed that the credit union was run by a clique for its own benefit.

Cost

As noted above, people on low-incomes recognised that special features to meet their needs often lead to extra costs. But they wanted these costs to be transparent from the outset – with no hidden costs that emerged only after they had signed (or committed themselves to signing) the agreement. They also resented price mark-ups on point of sale credit, especially when interest was also being charged.

Rental purchase was strongly criticised for both these reasons. People were attracted by the advertised low interest rates but found that high price mark-ups and optional extras (such as insurance) meant that, in reality, the costs were a great deal higher – often making it the most expensive of the options open to them.

In conclusion

Re-analysis of existing interview scripts, supplemented by a literature review, has provided some useful insights into the possible features of an affordable source of credit for people on low incomes. Future research will concentrate on the relative importance of each of these features – to provide a view of the minimum of basic features that an ideal source of credit should have and, as importantly, those it should really not have. It will also explore in more detail the trade-off between these features and cost, identifying the most people would pay for a 'silver service'.

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Appendix 1 Interview scripts re-analysed

Mail order
E. Kempson, A. Bryson and K. Rowlingson (1994) *Hard times? How poor families make ends meet.* London: Policy Studies Institute (75 scripts)

C. Whyley, S. Collard and E. Kempson (2000) *Saving and borrowing: use of the Social Fund Budgeting Loan scheme and community credit unions.* Department for Work and Pensions (30 scripts)

Home credit
S. Collard and E. Kempson (2003) *Pawnbokers and their customers.* National Pawnbrokers Association (30 scripts)

K. Rowlingson (1994) *Moneylenders and their customers.* Policy Studies Institute (30 scripts)

C. Whyley, S. Collard and E. Kempson (2000) *Saving and borrowing: use of the Social Fund Budgeting Loan scheme and community credit unions.* Department for Work and Pensions (30 scripts)

Pawnbroking
S. Collard and E. Kempson (2003) *Pawnbokers and their customers.* National Pawnbrokers Association (30 scripts)

C. Whyley, S. Collard and E. Kempson (2000) *Saving and borrowing: use of the Social Fund Budgeting Loan scheme and community credit unions.* Department for Work and Pensions (30 scripts)

Social Fund
E. Kempson, S. Collard and S. Taylor (2002) *Social Fund use amongst older people.* Department for Work and Pensions (30 scripts)

C. Whyley, S. Collard and E. Kempson (2000) *Saving and borrowing: use of the Social Fund Budgeting Loan scheme and community credit unions.* Department for Work and Pensions (30 scripts)

Credit unions
C. Whyley, S. Collard and E. Kempson (2000) *Saving and borrowing: use of the Social Fund Budgeting Loan scheme and community credit unions.* Department for Work and Pensions (30 scripts)