findings

Understanding and combating 'financial exclusion'

One and a half million households lack even the most basic of financial products, such as a current account and home contents insurance, and a further 4.4 million are on the margins of financial services provision. This is the key finding of new research by Elaine Kempson and Claire Whyley of the Personal Finance Research Centre. Their study found:

- **Financial exclusion is a complex and dynamic process. Some people experience short periods of exclusion, maybe more than once in their lives. For a small number, however, it can be long-term, perhaps even life-long.**

- **The majority of people without financial products are excluded by a combination of marketing, pricing and inappropriate product design. Although most have never used financial products, about a quarter have done so in the past. A small group, however, have either been refused access to financial products or make a conscious decision not to use them.**

- **Financial exclusion depends mainly on who you are, but where you live is also important. Those at highest risk were those who were: on low incomes; claiming means-tested benefits; single non-pensioners; from the Pakistani or Bangladeshi communities; in rented accommodation; or had left school before the age of sixteen. People living in Scotland or in one of the 50 most deprived local authorities in England and Wales were even more likely to be excluded than their personal or economic circumstances would suggest.**

- **Focus groups identified two main types of unmet need for financial products: to assist day-to-day money management and financial transactions; and for long-term financial security, such as providing for children. There was little expressed need for saving or consumer credit products to assist with the purchase of consumer goods.**

- **The researchers conclude that possible solutions to financial exclusion should focus on four main areas: reducing barriers to access; product design; delivery of services; and encouraging take-up. Tackling these may require action by government and financial institutions in partnership.**

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Despite a steady increase both in the number of households using financial services, and in the range of products available, around 1.5 million households in Britain (7 per cent) do not use financial services at all and a further 4.4 million (20 per cent) use just one or two.

'Financial exclusion' is a key policy concern because the options for operating a household budget without mainstream financial services are more expensive and often unregulated. For communities with limited access to financial products, this process becomes self-reinforcing and is an important factor in social exclusion.

Ironically, as the number of excluded households falls, the problems they face become more severe. Being without a current account, insurance, long-term investments or a pension is more important because these products are so much more common among the majority of households. Indeed, lacking financial products can contribute to more general social exclusion and most households in this position identify key areas of unmet need.

Who is affected?

The *likelihood* of being on the margins of financial services is clearly related to who you are, your financial circumstances and where you live. Statistical modelling showed that socio-economic factors are most significant in predicting financial exclusion. Being in receipt of income-related benefits had the largest effect, followed by having a low household income and the length of time since the head of household has been in paid work. Renting a home, being a single non-pensioner, being from the Pakistani or Bangladeshi communities or having left school before the age of 16 also increased the likelihood of financial exclusion. Finally, regional analysis showed that living in Scotland, Wales or Greater London increased the odds of a household being excluded. Analysis at the local authority level found that living in one of the fifty most deprived local authorities in England or Wales doubled the odds.

In addition, the number of households without specific financial products, such as a current account or private pension, is a great deal higher than overall levels of non-use. In general, use of specific financial products follows overall patterns of use. There is, however, evidence of a hierarchy. People who have only one or two products are most likely to have a current account or savings accounts with a building society or bank. At the other extreme, insurance provision for ill-health or loss of income is very rare among those who are most excluded, as are most investment products (TESSAs, PEPs, unit trusts etc).

The processes of exclusion

There is no single explanation for households being without financial products. Although three-quarters have never used financial services, a quarter have done so in the past. Equally, many of those who have never used financial products will almost certainly do so at some stage in their lives. Moreover, financial exclusion is a dynamic process. Many more households move in and out of exclusion than are without products at any one time. Further, large numbers of people are also on the margins of financial services provision and, therefore, potentially at risk of financial exclusion.

The qualitative stage of the research showed that those who have never made use of financial services fall into five main groups:

- Householders who have never had a secure job – the largest group.
- Elderly people (aged over 70) who are part of a cash-only generation.
- Young householders who have not yet made use of financial services, but may do so in the future.
- Women who became single mothers at an early age.
- Finally, some minority ethnic groups - particularly Pakistani and Bangladeshi households - make limited use of financial products due to language barriers, religious beliefs and lack of knowledge.

In general, the factors that inhibit use of financial services include: the lack of a secure job; having parents who do not use financial services; and living in marginalised communities.

People stop using financial services either due to a drop in income, or, for women, the loss of a partner, through separation or death, who held all the household's financial products. Following a drop in income, some people choose to disengage from financial products in order to keep tight control over their money. Others, however, only do so once they have fallen into financial difficulties and may have facilities withdrawn by suppliers. Likewise, some women left without financial products choose not to apply for replacements, while others apply but are turned down or do not apply because they believe they would be refused. Most of these people will start using financial services again if their income increases.

On the whole, then, large numbers of households are not denied access to financial products, but nor have they made an unconstrained choice to opt out. Instead, most face barriers which inhibit their use of financial services. These include:

- products being too expensive, for example, high home contents insurance premiums for people living in deprived areas;
- conditions attached to products which make them inappropriate, for example, a current account offered without a cheque-book, cheque guarantee card or cash-point card; and
- financial institutions which are not keen to attract people on low incomes as customers; consequently there is a lack of marketing to this group.

There is also evidence that some government policies may encourage or reinforce financial exclusion.

Unmet needs and the consequences of financial exclusion

People without access to financial products identified two broad areas of unmet need for financial services: for day-to-day money management and for long-term financial security. Medium-term security - insurance against loss of income, or loss or damage to possessions - was less important. In contrast, few people expressed a need for savings or consumer credit products. Indeed, there was considerable resistance to consumer credit *per se*.

Being without a current account means households deal entirely in cash. This complicates the process of bill-payment, results in charges for cash payments, and often increases the costs of basic services, such as fuel. It also causes problems when people need to issue or cash a cheque.

Lack of long-term financial security is a particular concern, as people expect state provision to decline still further in the future. Parents tend to put their children's needs first and only later begin to think about providing for their old age. Few expect to receive much in the way of a state pension and anticipate having to continue to work or face very real poverty.

Although medium-term security was less important, a minority of younger people wanted a way of supplementing state benefits while they were unable to work. Interestingly, these were almost all people who were without employment who wanted to avoid the difficulties of managing on benefit in the future. Home contents insurance, where it was a priority, was of secondary importance. Concerns centred on the difficulty of replacing stolen or damaged possessions.

Resistance to consumer credit was widespread but coupled with an acceptance that 'lumpy' expenditure could not be met without it. Limited access to short-term credit to smooth the household budget makes money management more difficult and can lead to arrears or the use of expensive moneylenders.

Meeting needs

Focus group participants felt overwhelmingly that most existing financial products were inappropriate to the needs of low-income households, and this explained the low levels of usage. Current provision is rarely designed for use by people with low incomes or unstable circumstances. Equally, the way in which financial products are delivered can also make it very difficult for low-income households to use them.

Nonetheless, meeting the needs of households that currently lack financial products need not be an insurmountable problem. Evidence from the focus groups suggests that their requirements are not greatly different from other consumers and that, while most products fail to meet the design and delivery needs of low-income households, it would not require major changes to make them more appropriate

Reducing barriers to access

Widening access requires overcoming the barriers presented by risk assessment as well as improving physical access. As it is clearly unrealistic to expect a reversal of the trend towards more precise risk assessment, product design and delivery will need to achieve the same effect.

Using intermediaries to deliver financial products can overcome the problems of physical access. Telephone and computer-based services, however, are likely to reinforce financial exclusion as many excluded households lack these facilities.

Product design

It was clear from the focus groups that the requirements of people without financial products are not unrealistic.

For day-to-day money management they required a simple account which would allow them to retain tight control over their money. It should offer basic money transfer facilities, including a facility for spreading the cost of bills. It would offer no credit facilities but have a 'buffer zone' to allow flexibility. Ideally, it should also be designed so that access is not dependent on credit scoring.

Products offering longer-term financial security should be simple and transparent so that users 'know where they are' and the costs associated with regulation compliance are low. They should be based on regular and automatic saving; flexible, so that products can be retained even during times of hardship; and give restricted access to the money saved. To reduce the likelihood of people cashing in long-term savings plans because of short-term needs for cash, long-term savings products could be used as collateral for small loans.

The key issue for home contents insurance was affordability and, in particular, options for spreading the cost of premiums across the year. Wider availability of simpler, cheaper products such as indemnity insurance (second-hand replacement value rather than new-for-old), or catastrophe-only policies could also widen access.

In addition, the focus groups identified the need for short-term credit facilities which offered: small, one-off, fixed-term loans rather than ongoing credit commitments such as credit cards or overdrafts; fixed, automatic repayments; and the use of technology in the distribution of loans and collection of repayments, which could reduce costs and therefore allow lower interest rates than are currently available from moneylenders.

Finally, there was a need for financial products that meet the requirements of Islam.

Delivery systems

A key finding from the focus groups was that people on the margins of financial services want to deal with organisations which are financially secure, trustworthy and understand their needs. It is not, however, necessary for the same organisation to both provide the product and deliver it to the customer. Indeed, experience shows that the use of intermediaries offers many advantages. For example, many local authorities run *insure with rent* schemes for tenants wanting home contents policies, which they are able to offer at a substantial saving on similar policies bought direct or through a broker. The Post Office is also exploring a similar role as financial service intermediary, as are a small number of credit unions and housing associations.

New technology offers some opportunities for product delivery at this end of the market. Electronic cards and electronic money transmissions are likely to be the most acceptable. Low levels of telephone and computer ownership among these households rule out solutions such as call centres, telebanking and on-line banking.

Encouraging take-up

Evidence from the focus groups confirms that knowledge of financial products is remarkably low among households that are without them. This is compounded by marketing policies which reinforce the belief that financial services are ‘not for the poor’. Measures to encourage take-up must, therefore, tackle the widespread mistrust which such households have of many financial providers, particularly those which are geographically remote. Use of trusted intermediaries could overcome these barriers. Targeted marketing and delivery of new products as they become available would also increase take-up. Equally, the language and cultural barriers faced by some potential users need to be taken into account.

There is also a need for an independent information and advice service. Lack of knowledge and experience of financial products renders some households especially vulnerable to mis-selling, as well as deterring them from taking up financial services.

Legislation and government policy

Financial exclusion is influenced by government policy and practice in a range of ways. First, payment of means-tested social security benefits by giro or order book clearly encourages recipients to operate a cash budget. Secondly, there is evidence that regulation of financial services can cause or reinforce financial exclusion. Thirdly, suggestions for future welfare reform may well add to the problem of financial exclusion, rather than addressing it. On a more positive note, government policies can create a new market for financial services. The proposed ‘stakeholder pension’ is one such example.

Moving forward

Since this research was started, there have been a number of significant developments that signify a willingness by a wide range of private and public sector organisations to tackle the problem of ‘financial exclusion’. Indeed, the climate of opinion is more disposed to tackling the problem than at any time in the past. Nonetheless, despite such developments, the resource limitations experienced by low-income households will continue to constrain their access to, and use of, financial products.

About the study

The research combined quantitative and qualitative techniques, including:

- secondary analysis of the 1995/96 *Family Resources Survey*, which interviewed 26,435 householders and covered 23 different financial products;
- analysis of data collected on two waves of the Office of National Statistics Omnibus Survey for the Office of Fair Trading review, *Vulnerable consumers and financial services*. These interviewed 3,708 householders;
- re-analysis of 87 depth interviews with those making no or very little use of mainstream financial services;
- five focus groups, involving 32 people making no or very little use of mainstream financial services. These were held in Scotland, England and Wales and included both rural and urban areas.

How to get further information

The full report, **Kept out or opted out? Understanding and combating financial exclusion** by Elaine Kempson and Claire Whyley, is published by the Policy Press in association with the Foundation (ISBN 1 86134 159 8, price £12.95 plus £2 p&p).