An extra 7 years before I'm debt free

The effect of the poverty premium on debt advice service users

Research Report

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TOYNBEE HALL

For a future without poverty

Research Team

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This research is a pilot study of Toynbee Hall's London-wide Poverty Premium Programme (2017 - 2020).

For further information on this research, please email Research@toynbeehall.org.uk.

Introduction

Using survey data, this primary research explores the poverty premium for people with unmanageable debt. We aimed to address the following questions:

- To what extent do they pay a poverty premium?
- Who is more likely to pay the premium?
- How do they cope with the costs?

The poverty premium is widely defined as the increased costs paid for essential goods and services by those on low incomes (Toynbee Hall 2014). This term was conceptualised nearly half a century ago, when American sociologist David Caplovitz (1967) addressed the processes by which poor people in New York pay more for the same products. Various studies in Britain have addressed the poverty premium. These studies (e.g. Save the Children 2007, 2010, 2014; Toynbee Hall 2014; Citizens Advice Scotland 2015; Davies et al 2016) discussed some common types of poverty premium including higher costs for utilities, goods, credit, borrowing and insurance. The premium could arise due to the need to pay by cash and the lack of payment method choices, the inability to buy in bulk, and the difficulty in accessing a variety of suppliers and so on (National Consumer Council 2004).

Amongst the above pioneering studies that give us a great insight, there is a lack of primary research to quantify the poverty premium, especially for people in debt.

For instance, Save the Children's (2007, 2010, 2014) illustration is based on the assumption that, within a year, all low-income families pay for the costs of a cooker, utilities, home contents insurance, car insurance, a £500 loan and cashing three £200 cheques. But people may not pay a poverty premium on all categories (Toynbee Hall 2014), and the actual amount depends on their specific circumstances, such as whether or not they have a car, and whether they are in debt (Save the Children 2007). It is therefore worth exploring how much people in debt are actually paying and who is likely to pay more.

This primary research is an attempt to fill in the gap by quantifying some major types of poverty premium for people in debt. Toynbee Hall manages a London-wide face-to-face debt advice service (Capitalise), giving us an incentive to understand the poverty premium for this user group whilst affording us privileged access to potential research participants.

Our survey

We conducted a survey with people who received debt advice from Toynbee Hall. We collected 101 questionnaires through phone calls (50%) and other channels (online 28% and face-to-face 22%). The sample had a fairly equal distribution of gender. The participants came from a wide range of age groups, and a large majority (76%) of them were between 30 and 59 years old. More than half of the respondents were from two ethnic minority groups, Black Africans (35%) and Bangladeshis (29%); and 86% rented their homes. The participants had an average household income (after housing costs) of £411 per month, much lower than the low income threshold (£1004) according to the DWP (2015) measurement[1].

We included 6 types of cost to measure the poverty premium: gas, electricity, credit card interest charges, banking charges, cash machine charges, and fees to secure private housing. Some of these costs were highlighted by previous research (e.g. Save the Children 2010, 2014; Toynbee Hall 2014) and some were identified by a key informant discussion attended by our colleagues specialising in debt advice, financial inclusion and financial capability. We also only included the premium categories which could be practically quantified in a small piece of research, as identified by the payment methods, APR and the actual additional costs.

We examined 58 data variables ranging from demographics (e.g. age and number of non-earning household members) to financial attributes (e.g. expenditure and how they pay for utilities).

In addition to descriptive analysis, we estimated univariate and multivariate ordinary least squares (OLS) models[2] to identify causal relationships, correlations, patterns and characteristics that best describe the poverty premium for people in debt (see Appendix 1 for analysis results).

We acknowledge the small sample size as a limitation. This was exploratory research that aimed to test hypotheses and inform our next area of investigation. We also appreciate the effort and commitment from our Research Assistants to obtain this sample. They approached a large number of potential participants through phone calls (389 people), emails (297 peoples) and face-to-face (22 people). The response rate was very low (15%), and it could be improved if more debt advice organisations were involved and advisors were able to encourage their clients to take part in the survey. On a positive note, as this is a quantitative study, the statistic results can be generalised to a larger population.

[1] According to the DWP (2015), individuals are in relative low income if they live in a household with an equivalised income below 60 per cent of average (median) income, which is £1004 per month. Income after housing costs is net income after tax and other deductions, excluding rent, water rates, mortgage interest payments, buildings insurance payments, ground rent and service charges. In this research, we did not ask people about building insurance payments and ground rent in order to reduce the length of the questionnaire.
[2] We consider a p-value ≤ 0.10 as statistical significance. Statistical significance allows us to generalize our finding from the sample to the general population.

Key findings

To what extent do debt advice clients pay a poverty premium?

In addition to their debt repayment, our participants paid an average poverty premium of £324 per year. This is a significant amount, particularly since nearly half (43%) of them made debt repayments of less than £324 per year. The average amount of debt for our participants was £7593 (similar to overall Capitalise debt advice data[3]), and the median for their debt repayments was £480 per year. So, in a hypothesis example, for a person who is paying £480 per year towards their £7593 debt, it would take around 16 years to pay off their debt. If they did not also have to pay the poverty premium (of £324 per year), it would take only around 9 years. In this case, their current poverty premium cost of £324 per year could be diverted instead to paying off their debt, making them debt free 7 years earlier.

This premium is the minimum amount as we have not included other possible types of premium on goods, insurance, services and cheque cashing. As we finalized this report, a study (Davies et al 2016) was publicised which takes into account of more types of poverty premium and suggests that the premium is £490 per year for low-income households (not necessarily in debt). It will be worth exploring other types of the premium for people in debt, but this necessitates a wider study. Also, it may be difficult to quantify the precise figure of certain categories of premium[4].

The poverty premium accounts for 7% of the participants' average household income after deducting housing costs. This is slightly less than Save the Children's (2007, 2014) estimates of 9% in 2007 and 8% in 2014. Save the Children's estimates show a slight reduction of the percentage over the years but an increase in the absolute amount of premium.

Electricity, gas and banking charges are the three major types of poverty premium. The survey data suggests that, in addition to gas and electricity which are commonly noted in the discussion of the poverty premium (e.g. Save the Children 2010, Toynbee Hall 2014), banking charges (such as overdraft penalty fees, credit card fees and check book issue fees) could be a premium that has a significant impact on people's finances. 27% of our participants paid banking charges in the last 12 months, with an average amount of £14 per month.

Tackling the poverty premium could help ease people's debt and improve their financial situation.

The poverty premium has a statistically significant impact on our participants' financial circumstances. Those who pay a higher poverty premium tend to have higher overall expenditure on utilities and other household bills (p-value 0.034). They also tend to miss more debt repayments (p-value 0.046).

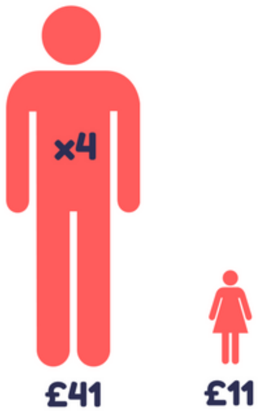
[3] The data (sample size 19,352) shows that our debt advice clients owe £7,292 on average.

[4] For example, calculating the poverty premium for a cooker involves multiple questions about the purchase and some searches on how much it would cost for families with a higher income; and the same model of cooker in Brighthouse may not be available in the mainstream market.

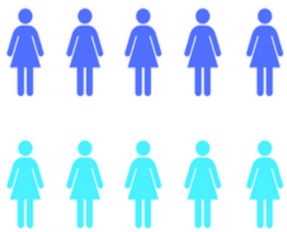
Who is more likely to pay the premium?

Our analysis highlights that some groups are more likely to pay a poverty premium. This could be influenced by their gender, housing and age.

Surprisingly, male participants pay four times higher poverty premium than female participants, accounting for £30 more per month (p-value 0.044). This is consistent with our larger debt advice client data (sample size 19,352), which suggests that on average men owe a higher amount of debt in electricity (1.5:1) and gas (1.1:1). This gender difference is interesting considering that the absolute number of male clients who seek face-to-face debt advice in electricity and gas is in fact half that of female clients; and face-to-face debt advice[5] and money management programmes[6] are used more by women. However, some evidence (Toynbee Hall 2015) suggests that men benefit more from practical money management training, such as reducing utility costs. Given that men pay a higher amount of poverty premium, it is worth exploring the gender difference in using other support channels such as online resource, and strengthening appropriate support for men.



In addition, council tenants are very vulnerable to paying poverty premium on electricity (p-value 0.016). Considering over half (56%) of the council tenants had no source of income or were in receipt of state benefits, the use of a meter key could increase their expenditure in addition to their unmanaged debts. Working with local councils could be an effective way to reach these vulnerable people. Also, it is worth noting that we only obtained a small sample of private renters - only 18% of the participants - despite one quarter of Londoners privately renting (Office for National Statistics 2011). This meant we were unable to analyse the poverty premium on this specific group at this stage but we see this as a priority for further research.

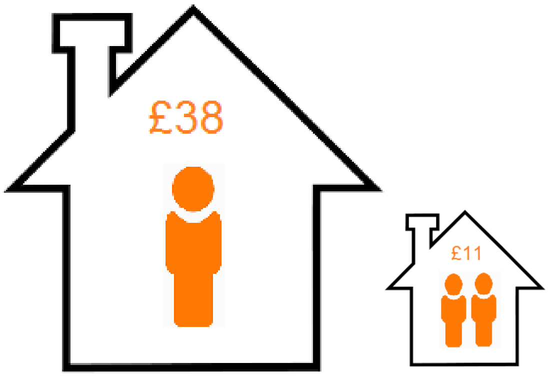


1 OUT OF 2 **COUNCIL TENANTS** PAY ELECTRICITY BY METER KEY

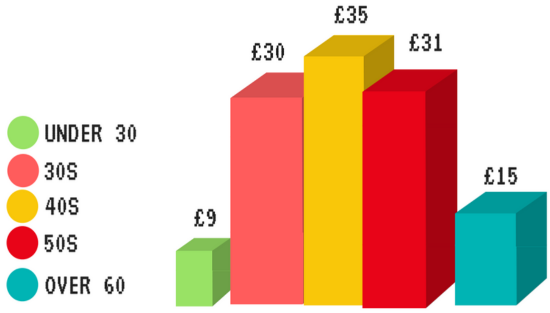
[5] Capitalise debt advice data (sample size 19,352) suggests that 57% of debt advice users are women.

[6] Toynbee Hall's Money Mentor Programme (sample size 421) suggests that 92% of its users are women.

Our participants who live alone pay nearly 4 times more poverty premium than those living with other adults, regardless of whether they have children or not (p-value 0.100). This supports our findings in the previous study (Toynbee Hall 2014) that people could be protected to some extent against paying poverty premium by having people to rely on for support.



Our sample shows that those aged between 30 and 59 pay a higher amount of poverty premium, drawing our attention to the 50-59 age group. This age group pays an average premium of £31 per month, similar to the amount paid by those in the 30-39 and 40-49 groups. Research from an analysis of government statistics and a nationwide survey (Saga 2011) suggests that people in their 50s could be worst hit by the rising cost of living and long term unemployment. Support in tackling the poverty premium could be very helpful for this age group.



How do they cope with the costs?

We tested whether people coped with the costs of their debt and the poverty premium by borrowing from others, reducing expenditure on essentials, getting into more debt, or using a food bank. The results suggest that people primarily tend to borrow from others and also reduce their expenditure on essentials.

22% of participants received support from a food bank. Meanwhile 38% of those who had not used a food bank had either the same level of income or lower, as those who did (£218 per month). This suggests that there may be a significant number of individuals who are eligible for support from food banks but who are not currently accessing the service, raising the question of why this might be. One possible reason is that food banks are only available at certain locations, agencies and times. Through a conversation with a local food bank provider we found that this could be also due to *'a stigma of using a food bank - people tend to rely on families and friends rather than food banks'* (food bank provider).

72% of respondents had borrowed from family, friends or other individuals in an effort to repay their debts. 75% of those who pay a poverty premium and 69% of those who do not pay a premium had borrowed from others. These figures are high when compared to the two earlier studies conducted at national and local level (Anderson et al. 2010 and Toynbee Hall 2014). These studies report that about 20% of people on low incomes (not necessarily in debt) borrow from informal networks. This possibly suggests that both unmanageable debt and the poverty premium push people with low incomes into a situation where they are relatively more likely to borrow from informal networks. Our research suggests a significant relationship between informal borrowing and debt repayment but further qualitative research is required to enrich our understanding.

58% of those paying a premium reported that they had to go without food, gas, electricity and/or water in order to pay off their debts; compared with 44% for those who do not pay a premium.

On a positive note, this study shows evidence that increased money management skills will improve people's financial situation.

A strong relationship exists between an individual's money management skills and their ability to sustain debt repayment (p-value 0.006), in that those with better skills are less likely to miss debt repayments. In addition, having better money management skills reduced our participants' poverty premium by 17% (£8 per month). Those who have a lower level of money management skills pay a premium of £47 per month, while those with a higher level of skills pay £39 per month. Finally, those with better money management skills are also less likely to borrow from others (p-value 0.073).

Money management skills are crucial to managing a long term financial situation such as debt repayment, but nearly 2 out of 5 of our participants did not know how long it would take them to pay off their debt. This figure is not surprising given that changes in an individual's circumstances can have a profound impact upon the speed – and indeed the likelihood – of repayment (Dearden et al. 2010). But it underscores the need of a holistic debt advice service and the importance of money management support and training.

No significant relationship exists between money management skills and age, ethnicity, gender, income and housing tenure. Therefore people may have a low level of money management skills in spite of their background, and money management training could be potentially beneficial for all.

44% of our participants were given advice on cost reduction. The sample shows that such advice had a positive impact on their money capability skills. However, the result is statistically insignificant. This may be due to the fact that debt advice service tends to focus on debt issues rather than on improving users' financial capability. It might be also possible that debt advice is not a suitable setting or stage for improving skills, as users are more concerned about their immediate debt crisis rather than long term solutions. It would be worth exploring the reasons further; and investigating how to support debt advice clients in improving money management skills and, furthermore, reducing the impact of the poverty premium.

Recommendations

Based on the key findings, we recommend that:

- Services work with those most vulnerable to paying a higher poverty premium. These could be men, those who live alone, council tenants and people in their 50s.

- Services work with the London Borough of Tower Hamlets and Tower Hamlets Homes in supporting council tenants manage money and debt.

- Debt advice clients be given appropriate support to improve their money management skills.

- Capitalise, the largest provider of free face-to-face debt advice in London, conducts further research with a bigger sample size.

  Such research could involve all partner organisations across London and would allow wider analyses such as geographical impact on the poverty premium, an effective approach to improve users' money management skills, and, also importantly, an appropriate debt advice process to support cost reduction methods to reduce the impact of the poverty premium.

- Further quantitative and qualitative studies are also required to conduct a more in-depth analysis focusing on the poverty premium for the above vulnerable groups and private renters.

Appendix 1: Analysis results

Below tables present the results of OLS models separately for each combination of dependent (in bold) and explanatory variables. The statistical significance of 5% and 10% is denoted by the signs ** and * respectively. Robust standard errors are in brackets.

Total amount of expenditure	
Annual amount of PP	.006** (.003)
PP on electricity	
Council tenant	.234** (.096)
Monthly amount of PP	
Live alone	-23.855* (14.582)
Borrowing	
Money management skills	.030* (.017)

Unable to make repayments last year	
No. of PP	.986** (.483)
Monthly amount of PP	
Gender	29.757** (14.556)
Unable to make repayments last year	
Money management skills	.354** (.127)
Money management skills	
Advice on cost reduction	-.703 (.703)

Impact of total debt and income on priorities

	P-1 Essentials	P-2 More Debt	P-3 Food Bank	P-4 Borrow from individuals
Net monthly income	0.00006	-0.00001	-0.00004	0.00011
	(0.00009)	(0.00008)	(0.00009)	(0.00011)
Total debt	-0.00005	-0.00001	-0.00002	-0.00008
	(0.00002)*	(0.00002)	(0.00002)	(0.00004)*
Observations	86	87	85	86

Appendix 2: Reference

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