

BANK EXCLUSION IN THE UNITED KINGDOM

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Deregulation of financial services has widened access to banking services for most people in the UK, but a minority have needs that are largely unmet by a competitive market. These needs include both personal and micro-enterprise banking and in, both cases, similar groups of people are affected for broadly similar reasons. The underlying explanation is that financial service providers view meeting the basic banking needs of people on low incomes as an uneconomic proposition. However, pressure from a government that is committed to financial and social inclusion has created a climate within which banks and other providers are investigating the potential for new product development at this end of the market.

Who is affected by bank exclusion?

Although only a minority of people is affected by bank exclusion, they are particularly concentrated among specific groups: people living on low incomes, tenants and those living in run-down and disadvantaged areas. Even among these groups it affects people in some circumstances more than it does others. People with an unstable work history, young people, women and people from African Caribbean, Pakistani or Bangladeshi communities are especially likely to be excluded.

Personal banking

Recent research has found that between 6 and 9 per cent of people in the UK do not have either a savings account or a current account with bank or building society¹. About twice that number specifically lack a current account. In addition to these people there is another 3 per cent of people who have an account but stopped using it (Kempson and Whyley, 1998a).

In general the youngest and oldest age groups have the highest likelihood of being unbanked. And women are more likely to have no bank account than men at all ages, but especially so if they are over 70. In terms of family circumstances, lone

parents and single pensioners are the least likely to have an account - especially if they are women.

Financial circumstances clearly play a big part. People who are unemployed or not working through sickness or disability are especially likely to be unbanked and are consequently, greatly over-represented relative to their proportions in the population as a whole. The longer people have been out of work, the less likely they are to have an account. So that half of people who have been out of work for more than ten years lack an account, compared with just over a quarter of those who last worked one year ago.

The lower a person's income and the more money they get in the form of benefits, the greater the likelihood of them not having a current account. Consequently, more than half (54 per cent) of people who receive income-related benefits because they are unable to work or have children and a low wage do not have an account.

Although only 8 per cent of people with an account are from one of the ethnic minority communities, the small numbers of ethnic minorities in the population hide the extent to which they are over-represented among non-account holders. Two groups stand out as having a very high likelihood of being unbanked: the Pakistanis, where 55 per cent of individuals do not have an account; and Bangladeshis, where the figure is 64 per cent. As might possibly be expected, these proportions are even higher for women than they are for men with 67 per cent of Pakistani women and 74 per cent of Bangladeshi women not having a current account of their own.

Of course many of these factors are inter-related and it is useful to be able to disentangle their effects. For example, are pensioners less likely to have a bank account because of their age, because they are no longer in work and needing an account for their wages or because they have a low income? Multivariate analysis techniques allow these interrelationships to be explored and to assess the extent to which individual characteristics (like age, being in work and income) have an independent effect net of all other characteristics (Kempson and Whyley, 1998a).

The factors that had the largest influence were ethnicity and economic circumstances. Being Pakistani, for example makes you four times as likely to be unbanked as a white person in similar

¹ Building societies are mutual organisations that were, originally, set up as organisations that offered facilities for savings and house purchase loans. Since they were de-regulated, many have converted to banks and those that remain now offer a full range of banking facilities.

personal and economic circumstances; while being Bangladeshi triples the odds. There seem to be a number of related reasons for this. These include a suspicion of British banks caused by language and cultural barriers, coupled with alleged racism by a minority of bank staff. In addition, the limited availability of Islamic banking products acts as a further barrier to use. Interestingly though, while African Caribbeans are very likely to be unbanked, this is largely explained by their family and financial circumstances rather than factors related to ethnicity.

Income *per se* does not have a large effect, although being out of work does. People who are not in paid employment are up to three times more likely to be unbanked than people who have a full-time work, but are identical in all other respects. Moreover, all other things being equal, a person who is in receipt of income-related benefit is twice as likely to have no account as someone not claiming any form of social security benefit. There are a number explanations for this finding. Some people who are not in paid work have never had an account. Some are refused bank accounts outright, some are offered one with such limited facilities that they choose to do without, while others do not even bother applying because they think their application will be turned down. A second group have had an account in the past. They either close it down when they cease to have a wage coming, in order to keep tighter control over their money, or they get into financial difficulties and the bank closes their account because they are overdrawn.

Surprisingly, gender does not have a significant independent effect, even though women are less likely to have an account than men. In other words, women are over-represented among the unbanked not because they are female, but because they are less likely to have an earned income from full-time work. Some of these women became mothers at an early age before they had opened an account; others have given up an account in their own name when they stop work to care for children. Following relationship breakdown, some women who are left on a very low income and without access to a bank account prefer a cash budget to keep control over their money. Others are refused an account when they apply or do not apply at all because they believe they will be refused.

In other words, there is a complex set of reasons why a minority of people do not have a bank account. For some it is because they have been refused one – or believe they would be. While for others, especially the very elderly, there is a clear preference for maintaining a cash budget, because

that is how they have always managed their affairs. For most, however, it is because there are barriers that deter them from using a bank account, ranging from a fear of using an account which allows you to overdraw, to feeling alienated from banks.

Micro-entrepreneurs

There are around 3.3 million micro-enterprises in the UK, with fewer than five employees – the great majority of which are sole traders. Among these, particular groups of people are both less likely to run businesses and, if they do so, more commonly encounter difficulties gaining access to bank funding. The evidence, however, is much less comprehensive than it is for personal banking.

Women and young people, aged under 25 are greatly under-represented among micro-entrepreneurs relative to their numbers in the workforce. And this is despite the fact that, if they are in business at all, women and young people are especially likely to have a micro-business. Similarly, African Caribbean people are under-represented among micro-entrepreneurs, although Asians (including people from Indian, Pakistani and Bangladeshi communities) are all much more likely to have their own business than people of white British origin (Kempson and Whyley, 1998b).

The available evidence suggests that between 15 and 20 per cent of micro-entrepreneurs approaching the banks for finance are unsuccessful in their attempt to raise credit. Qualitative research with women entrepreneurs found that half of them had faced difficulties raising finance (Carter and Cannon, 1988). While a number of studies have found that particular ethnic minority groups have disproportionate levels of difficulty raising money for micro-enterprises (Cosh and Hughes, 1997; Jones et al, 1997; Metcalf et al, 1997). For example, while 21 per cent of white entrepreneurs who had applied for a bank loan had encountered difficulties, 29 per cent of Asians and 39 per cent of African Caribbeans had done so. And among Asians, Pakistanis were twice as likely to have encountered difficulties as Indians.

There are clearly a number of factors that act to restrict access to bank finance by micro-entrepreneurs generally, but tend to impact disproportionately on the groups identified above. These include:

- bank lending criteria
- terms and costs of loans and current accounts
- fear and feelings of alienation
- alleged discrimination

Bank lending criteria frequently include appropriate business experience, investment of personal capital and collateral. Yet all three present a huge stumbling block for young people with little work experience of any kind; women returning to the labour force after caring for a family; and people 'pushed' into self-employment as a result of long-term unemployment. These people find it difficult to open business accounts, just as they do for their personal banking.

At the same time, there is some evidence that the terms and higher than average costs of bank finance deter some micro-entrepreneurs from applying, as does the cost of a current business account.

Young people, women, the long-term unemployed and some ethnic minorities are, as we have seen, under-represented among those using personal bank accounts. As a consequence many of them are unused to dealing with banks and are at a distinct disadvantage when it comes to making a business case for finance.

Added to which, women and ethnic minorities frequently report discrimination. African Caribbeans feel particularly disadvantaged in this respect and report that their loan applications are viewed more negatively than those from either white or Asian applicants (Jones et al, 1997). Likewise, women accuse banks of being sexist and patronising (Carter and Cannon, 1988); while Pakistani and Bangladeshi entrepreneurs believe that the high street banks often fail to understand the nature of the business they wish to run (Herbert and Kempson, 1996). Indeed, it has been found that funding of Asian businesses is both highly selective and stereotypical, so that those who are not running businesses that are considered typically Asian (such as take-away restaurants or corner shops) tend to be turned down for loans (Jones et al, 1997).

What are the unmet needs?

Among both personal customers and micro-entrepreneurs who are excluded from banks, there is a clear need for simple, transparent products, that reduce both the risk of financial difficulties and, as a consequence, the barriers to access.

Bank accounts

For personal customers, the prime need is for a basic account to handle money on a day-to-day basis. Such an account would include facilities

for:

- paying cash and cheques in
- holding money until it is needed and
- spreading the cost of bills

What they do not want is revolving credit facilities, such as overdrafts or credit cards.

Savings accounts would not meet the needs of most of the unbanked as they do not offer facilities for spreading the cost of bills. And current accounts are considered unsuitable, and therefore avoided, for two main reasons. First, there is the fact that they carry the possibility of unauthorised overdrawing. Secondly, the lack of transparency of such accounts is also problematic as it is difficult to identify, at any one time, which transactions have cleared the account. Together, these two shortcomings mean that people on very low incomes, which are stretched to the limit, often incur bank charges that are equivalent to at least a third of their weekly income.

In addition, the fact that bank accounts carry the possibility of overdrawing, means that anyone applying for an account is subject to credit scoring – which acts as a barrier for those not considered credit-worthy.

What is needed is a basic account that falls some way between a savings account and a current account, offering both transparency and a range of facilities, including bill-payment. It would not permit overdraft, although it would offer a 'buffer zone' protecting those who inadvertently overdraw by a small amount for a few days. Such an account would not need to be credit scored and so could be offered to everyone, including those who are currently excluded (Kempson and Whyley 1999)

Credit and business finance

There are remarkable similarities in the needs for personal and business loans among those who are currently excluded by the banks. They require relatively small amounts of money, and non-bank lenders in this end of the market have found that risks of default are greatly reduced by offering a series of short-term small loans rather than a single larger one for a longer period. Moreover, it becomes possible to increase the amounts lent, depending on the repayment history of previous loans (Loeff, 1999, forthcoming; Rowlingson, 1994).

Borrowers also welcome the repayment systems offered by the non-bank lenders; while the lenders themselves find that they reduce levels of default.

Typically, these place a personal obligation on the borrower to make the payment to a known individual at a set place and time. So, companies specialising in credit for the unbanked normally have agents who collect the repayments door-to-door on a fixed routine. Micro-lenders often employ group lending techniques where members of a group meet to pool their repayments for forwarding to the lender.

The third key element of credit in this market is the need for some flexibility over the timing of repayments at times of genuine pressure on household or business finances. Borrowers welcome being able to reschedule from time-to-time without incurring penalties for missed payments and almost all commercial and social lenders who provide credit at this end of the market adopt this practice.

Providers

A common complaint by both individuals and micro-entrepreneurs who are excluded from banks is that the banks are too remote and do not understand what it is like to live on a very low-income or to run a micro-business with a very small turnover. They, therefore, express a desire to deal with organisations that *do* have that understanding, although they would also like them to be reputable, large organisations that are secure financially. At the same time, there is a strong desire to be able to move on to mainstream banking if this becomes appropriate (Whyley and Kempson 1999). This suggests that the most appropriate method of delivery for both basic banking and credit is a bank working in co-operation with a not-for-profit organisation such as the Post Office, a credit union or a microlender.

Why have the banks not met these needs?

On the whole, the banks have not met the needs outlined above, because they consider them uneconomic. There is little profit to be made from a basic bank account or small loans with a higher than average risk of default. The need for a more personal service also adds to the cost. Moreover, such customers offer very limited opportunities for cross selling. In a competitive market, banks inevitably expend far more effort in creating new products and delivery systems for higher income users with more sophisticated banking requirements than they do for those on low incomes whose needs are modest. This need not remain so.

And how might they do so?

A number of banks in the UK have recognised that many of the people they do not serve may, with time, become mainstream customers. Research has shown that only a third of people in the lowest income quintile were still on such low incomes three years later (Jarvis and Jenkins 1997). Likewise, the experience of microlenders suggests that a high proportion of the micro-entrepreneurs they lend to not only remain trading but actually expand their businesses. In other words, many of those who seem unbankable now will almost certainly be considered bankable at some time in the future.

In addition, developments in technology mean that new products could be designed that would meet the needs of the unbanked. Indeed, some of the basic bank accounts developed for young people could well be adapted to meet the needs of people on low incomes. A number of banks are exploring this possibility and a small number have already launched new products.

Thirdly, there are growing opportunities for banks to be working with intermediaries such as the Post Office, credit unions and microlenders. Indeed, many of the banks are now developing links with these organisations.

The current UK government has given impetus to these developments with its emphasis on combating financial exclusion. The UK government is committed to delivering all social security payments by automatic cash transfer into bank accounts by the year 2003, so that all benefit claimants will need an account by that date. In addition, self-employment is one of the options suggested to unemployed people who must sign up to the New Deal – a scheme designed to help the unemployed find work. Access to start-up finance is an important component of assisting people to become self-employed. Two government action teams, working within the remit of the Social Exclusion unit, have looked at access to personal financial services and business start-up finance. Both are expected to produce far-reaching reports.

While financial exclusion remains a serious issue of concern, the political and commercial climate in the UK (if not continental Europe) has never been more favourably disposed to tackling it; only time will tell how far those who are excluded from banking can have their needs met.

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