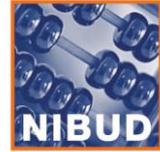


Financial attitudes and skills as early-warning signs of financial problems

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Introduction

On at least one occasion in 2011, nearly half of all Dutch households failed to pay a bill on time, were unable to withdraw money from a bank account, had earnings attached or had power cut off. Failure to pay the occasional bill on time is not a serious matter, but if arrears of payment accumulate and people can no longer meet their financial obligations, not only they but also those around them – and ultimately the rest of society – will suffer. An earlier study has shown that one Dutch household in ten¹ is at risk of getting into problem debt. It is therefore important to tackle financial problems as early as possible, and ideally to prevent them from arising in the first place. In order to deal with such problems effectively, we need to know who exactly is involved. Who are the high-risk groups for financial problems?

The study entitled *Kans op financiële problemen* ('Likelihood of financial problems', Madern & Van der Schors, 2012), which was conducted by the National Institute for Family Finance Information (Nibud) and funded by the Dutch Ministry of Finance's 'Money Wise Platform', looked at the factors that make people more likely to fall into arrears of payment. We asked 2,200 Dutch households about their financial attitudes and behaviour: whether they are in arrears of payment (and if so to what extent), what they do to keep track of their finances and what their general attitude to money is.

Arrears of payment

Financial problems occur in various forms and to varying degrees. Our study examined the prevalence and seriousness of arrears of payment. We defined 'minor arrears' as failing to pay bills on time, receiving late payment reminders, being overdrawn every month and/or having a direct-debit payment refused. 'Major arrears' included not only one or more of these, but also failing to pay the rent or mortgage, having earnings attached or having power cut off. Of our respondents, 8% had fallen into minor arrears just once and 24% more than once, and 14% had fallen into major arrears.

Early-warning signs of financial problems

Each year, Nibud's helpdesk answers hundreds of debt-related questions from consumers, some of whom are in serious financial difficulties. Callers give various explanations for their debts, but seldom blame themselves. Instead, they often mention external factors such as divorce, unemployment or poor financial advice.

In practice, as our study makes clear, things are less clear-cut. Many respondents in arrears of payment do indeed say that the arrears are due to specific events – 35% of them mention unexpected (or unexpectedly high), expenditure, and a quarter of them a drop in income – but some of them do acknowledge that their own behaviour is a contributing factor. For example, a third of our respondents stated that they had fallen into arrears because they had overlooked one or more bills, rather than because they did not have the money to pay them.

¹ C. M. van Ommeren *et al.*, *Huishoudens in de rode cijfers* ('Households in the red'), The Hague, Panteia, 2009.

To see which factors actually influence the likelihood of financial problems, we performed a multivariate analysis² in which 'having financial problems' was defined as 'having fallen into major arrears of payment at least once or minor arrears more than once'. Such analysis reveals whether financial problems really are – as people often imply – entirely due to external factors, or whether sociodemographic factors, personal factors and/or skills also play a part.

Sociodemographic factors

Some factors, such as a person's domestic situation or age, are facts of life. Sociodemographic factors are hard to influence, but they may affect people's likelihood of financial problems.

The analyses in our study show that households with children are more likely to have problems (it makes no difference whether there are two adults in the household or only one). Age is also a relevant factor: the likelihood of financial problems rises up to the age of 52, and then falls again. One possible explanation for this is that people's experience of money increases in the course of their lives, and so they get better at dealing with it. Up to a certain age, however, they are continually faced with new challenges that call for different approaches.

What is striking is that the size of a household's income does not affect the likelihood of financial problems, but that receiving social welfare benefits does. Home-owners are also less likely to have financial problems than people who pay rent. This is probably connected with the household's overall wealth.

Influence of life events

In most cases we have little or no control over whether life events happen to us – they either do or they don't. Taking all other influential factors into account, events associated with a drop in income or a rise in expenditure do indeed increase the likelihood of financial problems. However, this does not mean that people can do nothing to influence their impact. Households *that lose control of their finances* because of a particular event turn out to be at even greater risk of financial problems – in other words, what matters is *how they deal with* the event. It is therefore important that they should be able to seek and receive help whenever changes occur, so that they can get things back under control as soon as possible.

Financial skills

Although people in arrears of payment seldom acknowledge the fact, financial skills also affect the likelihood of financial problems. People who keep track of their income and expenditure, and plan ahead, are at less risk of such problems. So are people who keep specific records of their finances. Maintaining a savings account also reduces the likelihood of financial problems, for it says something about people's awareness of financial facilities and their ability to make use of financial products.

The above risk factors are easier to influence than a household's socioeconomic situation and life events. People with debts can be taught financial skills by those around them, or by professionals specialising in debt prevention, and so reduce their likelihood of getting into financial difficulties. It is important that people be taught such skills while they are still young. People who have learned how to deal with money in their childhood and adolescence are less likely to have financial problems.

Attitudes

However, it is not only the ability to plan ahead and maintain a savings account that matters. Another key factor is *willingness* to save. People who feel little or no need to save, and do not recognise the importance of doing so, are at greater risk of financial problems than those who do. There are two more attitudinal factors that play a part. People who are easily tempted, or are

² Logistic regression.

short-term thinkers, are more likely to get into difficulties. People we define as ‘easily tempted’ are those who themselves admit that they often feel tempted, regularly buy things they do not really need and find it hard to make choices. ‘Short-term thinkers’ are those who say they ‘live for the present’ and ‘don’t worry about tomorrow’.

Such attitudes are often deeply rooted in a person’s character, and hence harder to change. Yet they *can* be changed, if only in the long term. This is an area in which efforts to prevent people from getting into debt may prove particularly successful.

The importance of a positive attitude

We used multivariate analysis to determine the influence of the various factors in several scenarios. This reveals that having a ‘positive’ attitude – being willing to save, not being a short-term thinker and not being easily tempted – does more to prevent financial problems than having financial skills. A great deal can therefore be done by working on people’s financial and other attitudes.

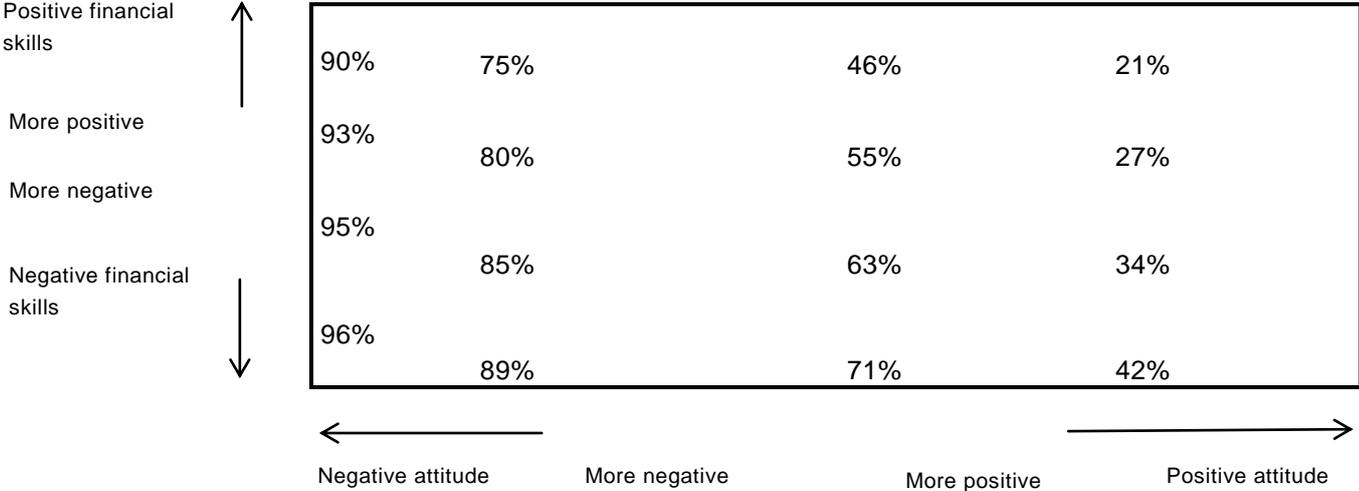
An example:

Jeroen is 35 years old. He lives with Claire, and they have two children. Jeroen is a manager working for a major telecoms firm. He has bought his own home. There have been no significant events in his life during the past year. Jeroen has had an average financial education.

What is the likelihood that Jeroen, as described above, will get into financial difficulties, and how will this be affected by his attitudes and skills? This is shown in the figure below. In his current situation, Jeroen has a 42% likelihood of financial problems if he has a positive attitude but no financial skills. If he also has financial skills, the likelihood of financial problems in his current situation falls to just 21%. If Jeroen has the right skills but the wrong attitudes (i.e. if he is a short-term thinker, is unwilling to save and is easily tempted), the likelihood that he will get into financial difficulties rises to an astonishing 90%.

In other words, the likelihood of problems is far greater in the absence of a positive financial attitude, but financial skills are also very important. What is more, people’s attitudes can be improved by working on their skills.

How attitudes and financial skills affect the likelihood of financial problems



Since Jeroen has children, his likelihood of financial problems is somewhat greater than if he had none. However, the risk is to some extent reduced by his average financial education and the fact that he is a home-owner. If he were 52 rather than 35 years old, with a positive attitude and good financial skills, he would be 5% more likely to have financial problems. If in the past year 35-year-old Jeroen had experienced a life event leading to a drop in income or a rise in expenditure, he would be 7% more likely to have financial problems. In other words, sociodemographic factors and life events do have an impact on the likelihood of problems, but attitudes and financial skills are still the main factors in determining whether financial problems arise and can be prevented.

Tackling the problem

In recent years there has been an increasing focus in the Netherlands on people's motivation and attitudes when faced with financial problems. This study shows that this is an area in which great improvements can be achieved, in addition to working on people's skills. In the past two years Nibud has also begun to focus more closely on behaviour and how to change it, especially in training courses. Local authorities and other bodies are showing interest. This study reveals three possible approaches:

Provide the right information and support as soon as a life event occurs, whether this is negative (unemployment, divorce) or positive (having children, moving away from home).

Show people the long-term impact of the choices they make now.

Look at ways to help people start thinking of savings as something attractive and important once more.

Here we can continue on the path already mapped out by field work. In recent years, debt relief efforts have increasingly focused on the person's own capabilities, character and behaviour. The idea is to motivate clients to change. Working on their intrinsic motivation, behaviour and skills is completely in line with the findings of this study.