

Numerically-challenged consumers hit in the pocket by loans

March 9 2012, By Emma Thorne



(PhysOrg.com) -- Consumers with poor financial skills pay over the odds for loans and are eight times more likely to use highly expensive credit such as payday loans and home credit, new research has revealed.

The research from The University of Nottingham on the UK consumer market published today, shows that [consumers](#) who have a poorer understanding of key financial concepts such as [interest rates](#) and [credit](#) terms pay nine percentage points more for loans than those with better numerical skills.

Professor Richard Disney and Dr. John Gathergood, of the University's School of Economics, analysed sample data 3,000 consumers surveyed by the market research organisation YouGov.

Doing the sums

Dr. Gathergood said: “Survey results show that poor understanding of loan terms such as APRs is associated with more use of high cost credit. There is a clear cost of ignorance in the consumer credit market.”

The researchers measured consumers’ understanding of loan terms using a series of questions about the cost of everyday credit products. For example, one question included in the survey was:

“Sarah owes £1000 on her credit card and the interest rate she is charged is 20 per cent per year compounded annually. If she didn’t pay anything off, at this interest rate, how many years would it take for the amount she owes to double?” Less than 5 years / Between 5 and 10 years / More than 10 years / Do not know.

Among consumers with outstanding debts, only 52 per cent correctly answered the question (less than 5 years), 36per cent chose one of the wrong answers and 12 per cent stated they did not know. Consumers’ answers to a series of questions were then analysed alongside information about their outstanding debts and the characteristics of those consumers.

The financial jargon minefield

The research also found that consumers with poor understanding of financial terms and concepts were typically aware of their lack of understanding. When asked to evaluate their own understanding of financial terms and calculations, consumers who performed poorly on the questions were more likely to state they were unsure about how to interpret financial information. Yet these consumers also stated they were less likely to read the financial pages in the news media and magazines in order to improve their understanding.

The UK consumer credit market is the second largest in the world, with

approximately £200 billion of consumer credit held by UK consumers. Last week, the group National Numeracy released results which showed that low financial numeracy imposed economic costs on the economy. The Nottingham research shows that poor financial numeracy imposes direct costs to consumers.

Government action on personal debt

It comes as the Department for Business Innovation and Skills Select Committee published the results of its inquiry into debt in the UK. Dr Gathergood testified before the Committee as an expert witness and argued that consumer misunderstanding of credit products was among the causes of debt problems in the population. The Committee has recommended that high cost payday lenders should be obliged to present clearer information about the cost of the credit products they offer when marketing their loans to consumers.

Provided by University of Nottingham

Citation: Numerically-challenged consumers hit in the pocket by loans (2012, March 9) retrieved 18 April 2024 from

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