Provident Financial and lending to people who are on low incomes

Lending and borrowing have caused all sorts of problems in recent years. The authorities are now proceeding with more caution, after their disastrous experiment with too much credit up to 2007 and too little in 2007-8.

The bulk of lending to individuals in the UK is to let us buy assets we cannot afford to buy outright. Most lending allows people to own a home. Over most time periods since 1945 houses have gone up in value, making the loans safe for the lenders and usually a sensible commitment for the borrowers. The lenders can normally get their money back if an individual can no longer afford the interest charges by agreeing a sale of the property. The older pattern of borrowing on mortgage when comparatively young also increased the security for the lender, as younger people often go on to gain promotion and pay rises making the mortgage more affordable. This would only cease to make sense if the authorities so deflated the system that they brought home prices down a long way.

Lending to let people buy cars also has some features of asset backed lending.If any individual is unable to keep up the payments the lender should be able to sell the car for all or most of the value of the loan. Only if the market overextended car loans greatly and then the authorities created recessionary conditions generally would this become a problem for the lenders who would stand to lose more from falling car prices.

The most difficult area is lending to people who need money to pay day by day bills. Here the lender has to make individual assessments about need and capacity to repay. Until recently Provident Financial has been successful for its shareholders by judging how much it can lend to people without assets and in need of immediate cash. It has chosen usually to lend for short periods of time at high interest rates, making it a profitable business. When this industry was subject to a Competition enquiry it was accepted that the clients on the whole wanted the service offered and were prepared to pay the high rates involved. Some would say they had no choice, as there was no lower priced credit on offer and they needed the money.

This week news has come out that Provident by changing its business approach is now finding it difficult to collect all the money owed on outstanding loans, and is unable to write as much new business as it was accustomed to do. Partly for regulatory reasons and partly for efficiency reasons the company decided to replace its network of Agents going house to house, building relationships with people in need of credit. These agents were rewarded based on their performance at collecting cash from clients. Instead it recruited 2500 Customer Experience Managers and equipped them with modern technology to enable more management information and regulatory control of the relationships. They are remunerated on a different basis. So far they have found it very difficult to collect all the money owing on the loans they have and to write enough new ones to keep it running as before.

What is the right answer to lending to people in need of cash for day to day spending? Could anyone do it for lower rates of interest? How should such a business adjust to new technology and current regulatory requirements? It does not look as if the problems at Provident are signs of some new massive credit crisis. They operate in a part of the market where the main banks do not get much involved.