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The Nature, Extent, Causes, and Consequences of Problematic Debt Situations

ABSTRACT. The paper reports on the most important and salient results of an investigation which was carried out in the Netherlands in 1980/1981. The object of the research was to establish the actual number of borrowers with a problematic debt situation and to provide an answer to the question of how the problems have arisen and what their consequences are for the borrowers and their families.

The research was divided into two parts:

— an investigation of the nature, extent, and causes of problematic debt situations (the survey part)

— an investigation of their consequences (the qualitative part).

In the explanation of how a problematic debt situation comes about, institutional, socio-economic, personality, and decision-behaviour factors were taken into account.

The results of both investigations provide an impetus for policy-makers to modify their policies aimed at preventing problematic debt situations from arising. Some starting points for such a re-orientation are discussed in this paper. The first point relates to the predictability of problematic debt situations and the implementation of an early warning system; the second point relates to the acceptance policy of financial institutions, in particular the use and functioning of credit score systems; the third point suggests restraint in the granting of additional credit to borrowers who have already taken out one or more credit; the fourth point relates to advice which could be provided to improve borrowers' (information-seeking) behaviour and level of knowledge.

Prompted by the alarming reports of the number of households in the Netherlands said to be suffering from financial difficulties partly as a result of their raising credit to finance consumer spending, an investigation was carried out in collaboration between SWOKA (Scientific Research Institute for Consumer Affairs) and IVA (the Institute for Social Science Research at Tilburg University). The object of the research was to establish the actual number of problem cases and to provide an answer to the question of how the problems had arisen and what their consequences were.

This paper reports on the most important and salient results of the investigation and discusses a number of its policy implications.

When consumer credit is mentioned in this paper it refers to credit in the form of personal loans, revolving cash credit, hire purchase financing, instalment credits, and credit on current accounts to finance spending in the consumer sphere. In addition it applies only to credits granted by (semi-)municipal credit banks, savings banks, general banks, cooperative banks, loan banks, and finance companies. Other debts which consumers may have, such as outstanding accounts with mail order companies, energy companies, or other suppliers, rent arrears, tax arrears, mortgage debts, and business credits, were not used as part of the sample frame.

THE RESEARCH FRAMEWORK

The research was divided into two parts:

- investigation of the nature, extent, and causes of problematic debt situations (the survey part)
- investigation of their consequences (the qualitative part).

By a problematic debt situation is meant "being in such a debt situation that a household can no longer meet its financial liabilities." Consequently a norm had to be developed in order to decide when exactly this situation can be said to exist.

The investigation of the causes and extent of debt situations was carried out in a survey of a representative group of borrowers ($n = 901$).

Because a longitudinal study into the causes of problematic debt situations would be too time-consuming and too expensive, it was decided to limit the research to measurement at a single point in time. The survey itself was preceded by a pilot study in order to test the questionnaire and the procedure for approaching and selecting the respondents, both of which were modified as a result. The full results of the survey are recorded in Dessart, Kuylen, and de Vries (1982).

In order to understand the consequences of a problematic debt situation for the individual members of a household and for the functioning of such a household, a qualitative investigation was carried out among some forty households with serious financial problems. This also provided some insight into the process which has led to the existence of a problematic debt situation. The forty households are not representative of all households in a problematic debt situation. The interviews do, however, give an idea of how those involved feel about such a situation and what underlying processes in their view have led to that situation. The results of this qualitative investigation is reported upon in Van Doorn (1982).

SAMPLING PROCEDURE

The results of the survey investigation relate to Dutch nationals with consumer credits (in the sense defined above).

All the respondents were registered with the Stichting Bureau Kredietregistratie (Credit Registration Bureau — BKR). This foundation records a number of details about borrowers to whom credit has been granted by lenders who are members of the foundation.

Over one-half of the total number of outstanding debts in the Netherlands and virtually all the registrable consumer credits falling within the framework of the investigation are registered with the BKR. At the time when the sample was taken (July 1st, 1980) there were 1.8 million contracts outstanding with a total of approximately 1.6 million borrowers.

The total number of contracts in which there were arrears of payment was 159,000; this represented 8.6% of the total number of outstanding contracts. The average number of outstanding credits per borrower was 1.2. This means that at the sample date there were approximately 126,000 borrowers with arrears of payment.

A stratified representative random sample was taken from the records of the BKR. In it the number of borrowers with arrears was oversampled. Interviews were conducted with 901 borrowers, of whom 398 had arrears of payment and 503 borrowers had no arrears of payment.

The interviews took place in the months of October and November 1980.

THE OPERATIONAL DEFINITION OF A PROBLEMATIC DEBT SITUATION

One of the most important tasks in this investigation was to find a way of identifying borrowers with a problematic debt situation. A number of variables were available (the arrears notification and arrears coding with the BKR, the debt-income ratio), which might function as indicators of such a situation. The variables could not be used single-handedly since none of them leads to a straightforward definition of problematic debt situations, but the registration of arrears with the BKR was used as part of the definition of problematic debt situations.

It is known that not all borrowers with an arrears notification have financial problems. It may, however, be assumed that if financial problems are so great that it is no longer possible to meet (other) financial liabilities, an arrears notification will eventually be recorded with the BKR. People whose arrears notification is an indicator of financial problems will have several characteristics in common, most of them indicative of financial problems.

In order to discover borrowers with a problematic debt situation, the total group of respondents was divided into two subgroups, viz., borrowers with and without an arrears notification at the moment when the sample was taken (numbering 398 and 503, respectively).

In order to establish which characteristics are frequently encountered among borrowers with and among those without an arrears notification, use was made of a classification technique known as the index method (De Jonge & Oppedijk van Veen, 1981). In essence, the index method is concerned, like discriminant analysis, with the generation of classification tables by means of classification functions. In contrast to two-group discriminant analysis, the index method does not require the number of classified groups to be equal to the number of actual groups. Instead of generating 2 by 2 classification tables the index method generates 2 by K classification tables. K is dependent on the number and importance of the

explanatory variables. As pointed out by de Jonge and Oppedijk van Veen, the originators of the method, the index method is robust in respect of such characteristics as heterogeneity of the population, lack of knowledge of the functional form of the relationship, and missing data. Moreover, the method can handle variables of different measurement levels and additive and interaction effects can be explored easily.

With the aid of this method variables were selected on the basis of their independent contribution towards discriminating between borrowers with and without an arrears notification. In other words variables were sought in which there was a large difference between borrowers with and borrowers without arrears.

Characteristics common to borrowers with an arrears notification turned out to include:

- an unfavourable relationship between the monthly fixed outgoings and the net disposable monthly income
- an overdrawn current account
- a relatively long term for the credit
- an unfavourable relationship between the outstanding balance of the credit and the net monthly family income
- an amount to be paid monthly for interest and repayment in excess of NLG 550.

Characteristics common to borrowers without an arrears notification were:

- current account not overdrawn
- an amount payable monthly for interest and repayment less than NLG 550
- a revolving cash credit
- the amount to be paid monthly for interest and repayment less than 12 percent of the net monthly family income.

The Number of Borrowers with a Problematic Debt Situation

An estimate of the total number of borrowers with a problematic debt situation was made on the basis of the classification table generated by the index method. Of the total of approximately 126,000 borrowers with an arrears notification at July 1st 1980, around 54,000 were in a problematic debt situation. This represents 3.4% of the total number of borrowers registered with the BKR, or over 40% of those with arrears in repayments.

In addition to these 54,000 borrowers with a problematic debt situation according to the above-mentioned operational definition, there were approximately 20,000 borrowers who subjectively were experiencing financial problems as indicated by their answers to certain questions in the questionnaire. These are borrowers, who in the year preceding the survey

were not always able to meet their financial liabilities, or who anticipated being unable to do so in the coming year.

In view of the estimating procedure employed, it may be assumed that the estimate of the number of problematic debt situations is conservative. The above findings relate to the state of affairs in 1980/1981. Since then a number of developments have occurred, which make it probable that the number of borrowers in a problematic debt situation has increased. There has been a marked deterioration in the general economic situation, as well as in the financial position of a large number of households in the Netherlands. The consequences of this for the credit market has been that consumers have been more cautious in taking out consumer credit and that financial institutions have tightened up their standards for acceptance and have become more restrained in granting credits. In spite of these developments, there is evidence of a rising trend in the number of outstanding credits with an arrears notification and/or arrears coding with the BKR since 1979, when the arrears rate was 6.9%; in 1983 it was 11.5%. The rise is however partly due to an increase in the registration of other types of credits with arrears (including mortgage credits and mail order credits).

Data concerning the increasing number of consumers who are no longer able to meet their mortgage liabilities, or have arrears with energy companies and/or rent arrears, also indicate that since the conclusion of the investigation the number of persons in more or less serious financial difficulties has risen rather than declined.

The Predictability of the Arrears Notification

In addition to borrowers with a problematic debt situation there were also some without an arrears notification during the investigation, who nevertheless had a large number of the characteristics of borrowers with, and virtually no characteristics of borrowers without, an arrears notification. A subsequent check with the BKR, one year after the survey research took place, showed that of this relatively small group of borrowers, over 50% had an arrears notification. Apparently the above-mentioned method can be used as an early warning system for borrowers who will experience financial problems in the future.

THE THEORETICAL FRAMEWORK

On the basis of a literature review (Kuylen, 1979) a conceptual model was drawn up, in which assumed relationships between independent and dependent variables were specified.

In this model, four classes of factors to explain the creation of

problematic debt situation are distinguished. These are: the institutional (marketing-mix) factors, the socio-economic factors, the personality factors, and the decision-behaviour factors.

The relationships among these factors should be thought of as follows:

1. Problematic debt situations, defined as a specific credit position, are seen as dependent on institutional, socio-economic, decision-behaviour, and psychological variables.

2. There are a number of the decision-behaviour variables which are influenced by socio-economic and psychological variables, and which are considered to provide explanations for differences between problematic and nonproblematic debt situations. Special attention is paid to the role of unexpected events as a cause of problematic debt situations.

3. The relationship between socio-economic and decision-behaviour variables is expected not to be identical for all consumers. For example, a high level of education will not lead to adequate financial management in all cases, but only when there is the necessary psychological make-up (internal control). The psychological variables indicate in specific cases the conditions under which there is a relationship between socio-economic variables on the one hand and decision-behaviour variables on the other. Internal control is seen as a prerequisite to capture uncertain future events in the decision process.

THE RESULTS OF THE SURVEY: FACTORS LEADING UP TO A PROBLEMATIC DEBT SITUATION

Within each block of variables the variables discriminating most between borrowers with and without a problematic debt situation were traced, making use of the index method. For each class of factors the most important explanatory variables within that class will be indicated.

The Institutional Factors

The institutional factors are the influences exerted by the lender on the borrowers' credit behaviour, such as the presentation of the credit product, the method of distribution, the price, the sales promotion, the use of a credit score system, and the acceptance policy.

Three indicators are included in this investigation: the distribution channel, the method of evaluating a client's credit worthiness, and the acceptance policy in the form of the risk accepted by lenders as expressed by the number of credit agreements concluded.

The number of outstanding credits is revealed by the survey to be the

TABLE I
 Summary of Standard Discriminatory Success (SDS) for Each of the Important Institutional Factors and the Total Discriminatory Success for all the Institutional Factors

Institutional factors	SDS ^a
Distribution channel; 1 outstanding credit	.55
(1) " " 2 outstanding credits	.03
" " 3 outstanding credits	.00
(2) Credit worthiness system	.23
(3) Number of outstanding credits	.75
(4) (1), (2), and (3) combined	.83

^a The standard discriminatory success (SDS) reflects the success of classification operations. The value of SDS always lies between 0 and 1. SDS is equal to 0 if both classified groups contain identical proportions of actual group II members (and hence, also identical proportions of actual group I members). SDS is equal to 1 if $n_{12} = n_{21} = 0$, that is if proportions of "false negatives" and "false positives" are 0 and all cases are correctly classified. The index method aims to find combinations of variables that maximise the value of SDS.

most important institutional factor in the creation of problematic debt situations. The more outstanding credits borrowers have, the more frequently do problematic debt situations occur., Of the borrowers with one outstanding credit 0.41% have a problematic debt situation. With two outstanding credits the figure is 15%, and with three outstanding credits it is 35%.

The number of outstanding credits actually reflects the risk acceptance policy of lenders. If lenders do not take over outstanding credits by means of a complete refinancing (transfer of debt), borrowers are granted a second or third credit. However, even if refinancing has taken place, with the result that only one credit is outstanding, it is found that such borrowers more frequently get into a problematic debt situation. Thus in both cases the raising/granting of extra credit is frequently associated with problematic debt situations.

If the characteristic "arrears or no arrears" is employed as a dependent variable, it appears that the probability of arrears is greater when the credit agreement has been concluded via an intermediary (insurance agent, supplier of goods on hire purchase, or finance broker) than directly with the lender (55% and 37%, respectively), i.e., the distribution channel has an impact.

For borrowers with one credit, the distribution channel is also significant; specifically where the credit has been taken out via an intermediary, the probability of a problematic debt situation is roughly two-and-a-half times as great as a credit which has originated through any other channel.

The link between the frequency of problematic debt situations and the type of distribution channel or evaluation system disappears when the borrowers in question have two or more outstanding credits. And those are the borrowers with a higher risk. Obviously the more risk institutions accept in granting credits, the greater the number of problematic debt situations and the smaller the differences between suppliers of credit in terms of numbers of problematic debt situations.

Where financial institutions employ an objective system for evaluating the credit worthiness of their clients (a credit score system) fewer problematic debt situations are encountered than with institutions which do not do so. Evidently, important factors are then less likely to be ignored than in an evaluation of credit worthiness based entirely on impressions gained in a personal interview with potential clients.

The Socio-Economic Factors

The most important socio-economic variables related to problematic debt situations are family life cycle, years of work experience, income, and a number of other variables which can be described as indicators of the financial spending capacity (such as existence of additional income, financial reserves, financial liabilities to mail order companies and family). Households with children in the 7 to 18 age group are faced with relatively high costs and partly for that reason are more likely to have financial problems. Tenants have financial problems more often than owner-occupiers. Those with a minimum income get into problematic debt situations more frequently than those with a higher income.

Problems are also encountered particularly among those who have additional income from such sources as overtime, renting out rooms, moonlighting, etc. It seems that the incidental earnings are intended to solve existing financial problems rather than to build up a financial reserve. It looks as if these are consumers who try to escape from a problematic debt situation.

Finally problematic debt situations are encountered more frequently among those who have debts with mail order companies and with third parties than among those who do not.

TABLE II
Summary of the Most Discriminating Socio-Economic Variables in Respect of Problematic Debt Situations

Description	Promotes problematic debt situations	Inhibits problematic debt situations	SDS ^a
Family phase	man and wife with children born between 1962 and 1973	man and wife without children, wife born before 1944	.17 ^b
Number of insurance policies	relatively few (0–3)	—	.15
Average length of employment with previous employers	—	4 to 9 years	.13
Are there financial liabilities to mail order companies?	yes	—	.12
Home ownership	tenant	owner-occupier	.09
Net monthly income of family	up to approx. fl. 1400	—	.07
Is significant drop in income expected?	—	no drop in income is expected	.06
Possession of Eurocheques? ^c	no	yes	.06
Civil status	widow/widower, divorced	—	.06
Total fixed monthly outgoings	up to fl.400 or more than fl.3000 per month	—	.05
Satisfaction with income or career prospects	not satisfied	—	.05
What is the main source of income?	unemployment benefit or reduced pay	—	.05
Financial reserve/ additional income?	—	interest on money deposits, shares, debentures, etc.	.05
Does breadwinner have to pay alimony?	yes	—	.05
Number of expensive/ luxury consumer durables	2 or less	4 or more	.04
Ownership of a boat	—	yes	.04

Table II (Continued)

Description	Promotes problematic debt situations	Inhibits problematic debt situations	SDS ^a
Number of bank and/or giro accounts	2 or less	4 or more	.04
For what period is income received?	every 2 weeks, irregularly	—	.02
Total SDS			.38 ^d

^a See Note 1, Table I.

^b The SDS values are the bivariate values, which indicate the relationship between the dependent and a single independent variable.

^c The Eurocheques are found to have the greatest discriminating capacity of all the guaranteed payment cheques. The other guaranteed payment cheques do discriminate, but add nothing to the variables selected here.

^d The total SDS value takes the correlations among all the independent variables with respect to the dependent variable into account and is consequently lower than the sum of all the individual SDS values, given that the independent variables are not all mutually independent.

The Psychological Factors

People can be characterised according to the degree to which they feel able to control the situation in which they find themselves (in psychology and social psychology this is known as the locus of control concept, Rotter, 1966). In this study, the variable "locus of control" turns out to be the most discriminating personality factor.

The more borrowers feel that they can control their lives and the things around them (internal control), the less likely they are to get into financial difficulties. Features which characterise such people, in contrast to those who do not have this feeling, are that in general they think ahead more, act more according to plan, are better informed, make decisions more rationally, and are better able to defer the satisfaction of their needs in the short term for the sake of the satisfaction of their needs in the long term, in other words they act less impulsively. If in spite of this they unexpectedly get into financial difficulties, they more often attribute the causes to themselves than do borrowers who believe that they cannot control their situation. The latter often blame external causes, such as divorce, unemployment, unexpectedly high expenses, and sickness.

TABLE III
Summary of the Most Discriminating Psychological Variables in Relation to Problematic Debt Situations

Description	Promotes problematic debt situations	Inhibits problematic debt situations	SDS
Specific locus of control	external control	internal control	.21
How is the development of the economy viewed?	the development of the economy in the short (2 years) and long term (over 2 years) is seen as favourable	—	.08
What is the time-orientation?	chiefly oriented to future or past (not to present)	—	.08
Willingness to defer satisfaction of needs in the short term?	no	yes	.07
Is financial management considered important?	—	very important or very unimportant	.05
Total SDS			.31

Decision-Behaviour Factors

Problematic debt situations are encountered less frequently among borrowers who have taken a well-considered decision about the credit to be raised than among borrowers who have not done so. That the decision about the credit was well considered is evident from such decision-makers' greater knowledge of financial institutions and forms of credit and of the perceived differences among them. Indicative is also their knowledge of the costs of the credit and the sources of information — such as consumer organisations — which have been consulted.

Another discriminating variable is found to be the perception of the availability of guaranteed payment cheques. Since it is not the availability as such, but the use made of the cheques which is important, this question seems to be an indicator of financial management. It appears that people who are careless in the use of the cheques also do little about financial management in other respects.

In addition the importance attached to the term of the credit and the interest rate seems to have a restraining effect on problematic debt situations. Borrowers who consider the term of the credit and/or a low interest rate to be unimportant run a greater risk of a problematic debt situation than borrowers who do consider these credit features to be important. The differences in decision behaviour between borrowers with and without a problematic debt situation are presented in Table IV.

TABLE IV
Summary of the Most Discriminating Decision-Behaviour Variables in Relation to Problematic Debt Situations

Description	Promotes problematic debt situations	Inhibits problematic debt situations	SDS
Evaluation of possession of guaranteed payment cheques	The disadvantage is that you do not know how much you are spending and spend money too easily	There are no disadvantages to guaranteed payment cheques	.23
Knowledge (objective)	moderate	very high, very low	.16
Is way of applying for loan important?	yes	—	.14
Is reliability of financial institution important?	no	—	.12
Is term of the credit important?	no	yes	.09
Is a low (8%) interest rate important?	no	yes	.08
Was information obtained from consumer organisation?	—	yes	.04
Total SDS			.49

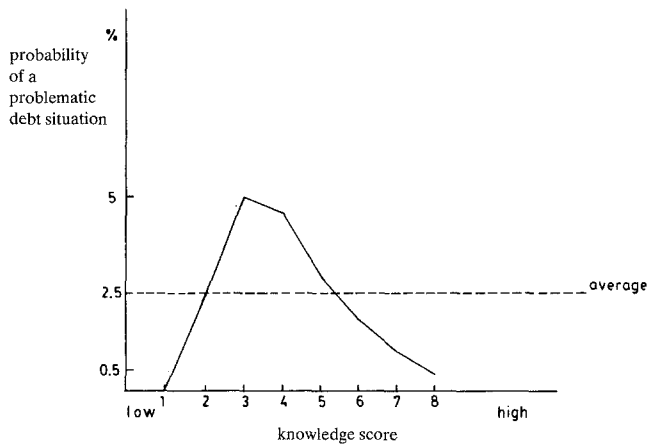


Fig. 1. The relationship between the probability of being in a problematic debt situation and the level of knowledge.

The relation between the level of knowledge and the occurrence of problematic debt situations proved to be curvilinear (as indicated in Figure 1). Borrowers with a very low or high level of knowledge have a low probability of getting into a problematic debt situation.

Further examination of this curvilinear relation reveals that insofar as knowledge plays a role in the occurrence of problematic debt situations, it is not only a question of actual knowledge, but also of the extent of the knowledge which people claim for themselves. It appears from the investigation that people who claim little knowledge, regardless of whether the actual level of knowledge is high or low, are far more cautious in their decisions and have a lower probability for a problematic debt situation. On the other hand, people who have a low to moderate level of knowledge about forms of credit and financial institutions (scores 2 to 5 in Figure 1), but who are not aware of their lack of knowledge, run a far greater risk of a problematic debt situation. By comparison with others, these people more frequently take out a loan via an intermediary. They mainly come from the lower income groups.

People who have little actual knowledge and who recognise this are found to have been very cautious in their decision about credit. Although this category of borrowers also comes from the lower income groups, the probability of a problematic debt situation is slight. They can be typified by the facts that they check whether they can afford the credit and that the monthly outgoings are not too high.

Evaluation of the Research Model

Above, the variables discriminating the most between borrowers with and without a problematic debt situation for the four classes of factors have been indicated.

Table V gives the discriminating capacity, indicated by the SDS-statistic, of each of the four different blocks of factors included in the conceptual model. From this table, it can be deduced that the institutional

TABLE V
Summary of the Discriminating Capacity of the
Various Blocks of Variables from the Conceptual
Model

Description of the block	SDS
(1) Institutional factors	.83
(2) Socio-economic variables	.38
(3) Psychological variables	.31
(4) Decision-behaviour variables	.49

factors, as indicated most strongly by the number of credits, are the ones most suited to distinguish between borrowers with and borrowers without a problematic debt situation. In absolute terms the other classes of factors carry far less weight.

More detailed analyses, however, show that there is an interactive relationship between the institutional factors on the one side and the other (more personal) factors on the other. The personal factors can inhibit the effect of the institutional factors, as the following shows. Here, the number of outstanding credits is used as an indicator of the institutional factors.

In a situation where only one credit is outstanding the probability of a problematic debt situation is slight, regardless of the characteristics of the borrower. If a borrower has two or more credits outstanding (the situation in which the institutional factors are unfavourable) the individual characteristics of the borrower are very important. Borrowers with favourable personal characteristics rarely get into difficulties, while borrowers with an unfavourable constellation of individual characteristics are almost certain to have financial problems. These findings are shown graphically in Figure 2.

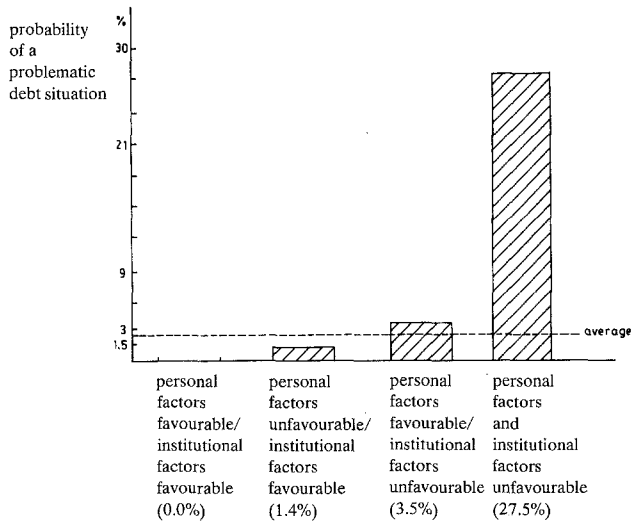


Fig. 2. The interactive relationship between the institutional factors and borrowers' personal characteristics.

THE QUALITATIVE STUDY AND ITS RELATIONSHIP TO THE SAMPLE SURVEY

The qualitative study had goals very different from those of the sample survey. In the qualitative study the emphasis was on the borrower's personal experience of the problematic debt situation and on his or her

perception of the causes which had contributed to that situation. This emphasis also influenced the choice of research method. Semi-structured interviews were conducted with the borrowers in question, in which the whole body of (family) problems as experienced by the borrowers was discussed. This also means that the conclusions which may be drawn from the qualitative investigation are of a different nature from those drawn from the results of the survey. Conclusions of a quantitative nature, similar to those from the survey, cannot be drawn.

It must be stressed that the group of forty households is not representative of the entire group of borrowers, numbering 54,000 at the end of 1980, who had a problematic debt situation. The group is characterised by the fact that they were households with whom a debt settlement had been arranged through the intermediary of a municipal credit bank. They therefore differ from the overall group of borrowers in a problematic debt situation in that they were all at a stage of the situation in which they were engaged in the implementation of a debt settlement arrangement. A debt settlement through the intermediary of a municipal credit bank will not be arranged with all those who are in a problematic debt situation. Moreover not all the attempts at mediation by a municipal credit bank will lead to an actual debt settlement arrangement.

The interviews with the forty households show, however, the underlying processes which are operative in creating a problematic debt situation and indicate, in a representative way, what a problematic debt situation can lead to in the extreme case.

The conclusions which can be drawn on the basis of the qualitative investigation are supplementary to those formulated on the basis of the survey. The interviews took place in the period from November 1981 to March 1982.

The Results of the Qualitative Investigation

The most important results of the qualitative investigation can best be described with the aid of the model presented in Figure 3. This model, which is derived from the interviews held, represents the process which takes place in the course of time. Two phases are distinguished in this process. The first phase runs from the moment at which the first consumer credit is taken out up to and including the moment when the first disruptions in the financial equilibrium take place. The second phase runs from the moment when measures are taken to deal with the financial problems which have arisen up to and including the period of debt clearance, which is where all the respondents were at the time of the interview. Both phases are elucidated below, item by item.

1. In the initial situation a combination of the following factors generally exists:

- an unsteady financial equilibrium, in which the raising of one or

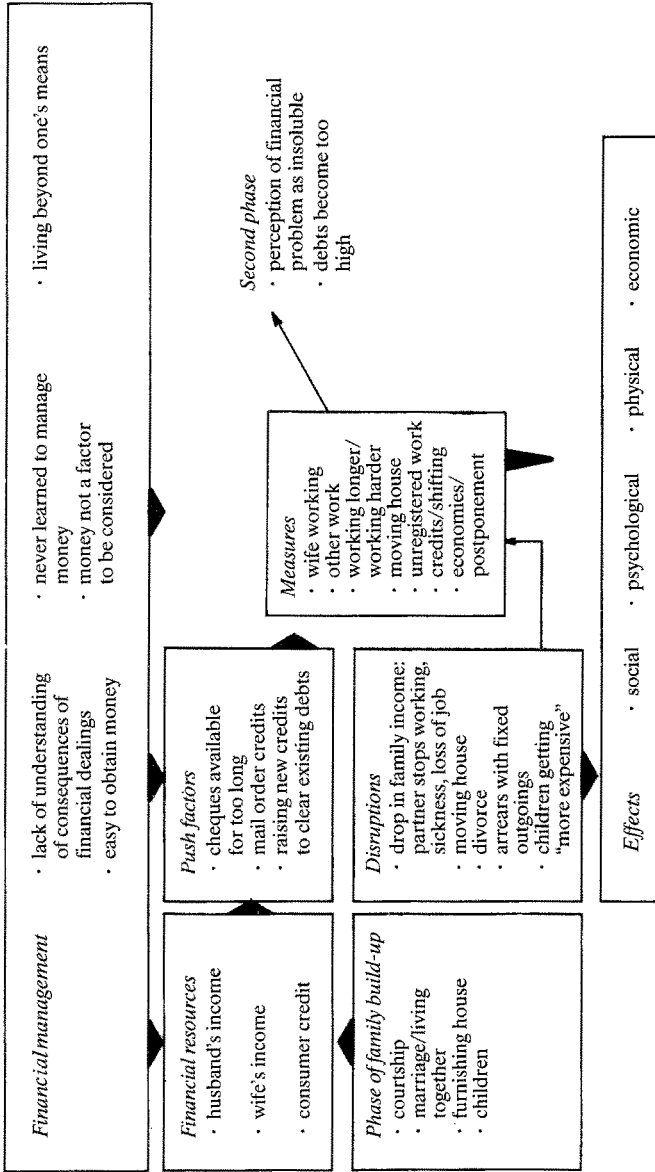


Fig. 3, Part 1. First phase: The growing problematic debt situation.

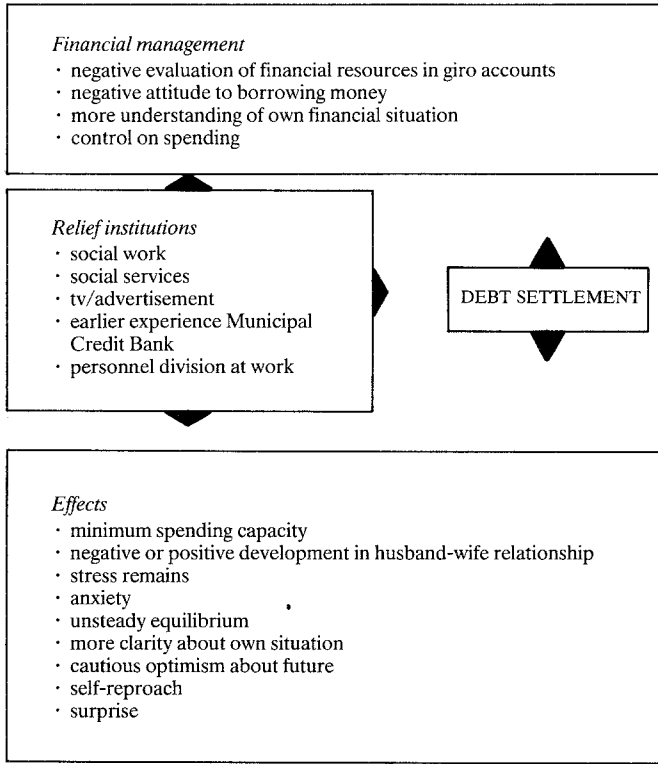


Fig. 3, Part 2. Second phase: The manifest problematic debt situation.

more credits has had the function of expanding the family income, drawing a cheque on the both uncertain and unpredictable future

- the absence of a systematic approach to the respondent’s own financial resources and the management of these
- the inability to evaluate the future consequences of financial liabilities which have been incurred
- the availability of credit facilities (credit card, paying cheques, etc.), offering an opportunity to camouflage the financial problems
- a positive attitude towards the raising of credit, and an optimistic, carefree attitude towards the (future) financial situation.

The development of the problematic debt situation is found to run largely synchronously with the various phases in the development of the family. The credits raised are based on the financial scope which the family has in its first phase, when both partners are working and childless. An important point is the fact that the financial consequences of family development have not been taken into account, but have rather been dealt with by the raising of further credit.

Roughly speaking it can be stated that in a second phase of the development of the problematic debt situation a number of "disruptions" in the unsteady financial equilibrium occur in succession. These disruptions are specifically:

- living beyond one's means for too long
- reduction in income, for example because a partner stops working, by choice or by force
- loss of employment
- sickness (in which financial liabilities which are often based on "inflated" incomes become a heavier burden)
- moving (sometimes due to divorce).

The most important factor now is that in the final phase of the developing problem all elasticity with regard to possibilities for coping with (approaching) set-backs has disappeared, because, of course, no financial reserves have been built up.

The fact that the original attitude to financial management (characterised by a high level of unconcern) does not in itself undergo any change during the process of deterioration of the financial circumstances, is an important aspect within the whole process.

2. In the first instance the developing problem is still seen as a question which can be solved by input of one's own resources. Not until such measures as the effort to earn more income, the postponement of payments until the receipt of holiday allowance or child benefit, moving to another home, and "clearance" with the aid of new credit, have provided no relief, and often enough have only increased the difficulties, is the problem finally recognised as insoluble.

3. The consequences which the developing problematic debt situation has for those affected must also be seen in a dynamic perspective. For the majority of respondents it is true to say that their material circumstances (spending capacity) deteriorate gradually and finally drop to an unacceptable minimum subsistence level.

Borrowers also become more and more "socially" isolated, on the one hand because of a reluctance to talk about their own situation for reasons of pride and embarrassment, and on the other hand because the financial needs which a social life involves can no longer be satisfied. It is obvious that this will often be accompanied by increasing psychological stress. In this respect, the whole range of depressive symptoms (sleeplessness, anxiety, aggression, etc.) is encountered. If this type of phenomenon occurs, the sufferer becomes less and less able to cope with the still deteriorating financial situation. At the final stage serious tensions occur in personal relationships, as well as all kinds of complaints of a psychosomatic nature.

4. Not until a debt settlement arrangement is about to be made is there any question of a change in the initial attitude to the person's own financial possibilities which has been described above.

In an evaluation of the debt settlement arrangement and the contacts being maintained with regard to the arrangement, the following are mentioned, for example:

- pleasure at the fact that matters are now understood rather more clearly
- surprise at having been so stupid as to incur such great financial burdens as have in fact been incurred
- amazement about the fact that lenders have granted credit(s) so easily.

In addition there are many reactions along the lines of “never borrow again,” “no more cheques.”

5. Returning to the way in which money was borrowed in the first place, it is noticeable that the actual availability of the credit (and the consequent speed with which the money can be obtained) was also an important factor. It seems as if the judgment of whether one can “borrow money because one can afford the repayments” has been delegated to the authority which the provider of credit represents. Illustrative in this respect are those respondents who (after an initial rejection) went in search of another lender who would react positively to their request for more credit. The judgement of the “rejector” was then seen as less relevant than the judgement of the “provider.” The experiences of financial institutions with potential borrowers who are annoyed if a credit they have requested is refused by the lender are a significant sign.

POLICY IMPLICATIONS

The results of both the sample survey and the qualitative investigation provide some starting-points for policy-makers (the government, credit institutions, and consumer organisations) who want to modify their policies aimed at preventing problematic debt situations from arising.

1. Firstly, there is the aspect of the predictability of problematic debt situations. It is concluded above, in the discussion of the results of the survey, that the credit characteristics used to reveal problematic debt situations can also be employed to predict which borrowers will receive an arrears notification and will in time find themselves in a problematic debt situation.

This result of the survey has a greater significance than the fact, important enough in itself, that it represents a validation of the research. It means in fact that it is possible to predict during the term of the credit, on the basis of a number of credit characteristics, which borrowers will ultimately find themselves in a problematic debt situation, and which will not. This potentially provides the lender with an important instrument for preventing an arrears notification from developing further in the direction of an insoluble problematic debt situation. We are thinking in terms of a detection system, frequently referred to also as an “early warning” system.

The desirability of the development of such a system is also indicated by the results of the qualitative investigation. This relates to the finding that borrowers with serious financial problems first contact relief institutions such as social services, a municipal credit bank, or a social work organisation, or the financial institution which has provided the credit in question, at a stage when the financial problem is definitively recognised as insoluble. By then the financial and other related family problems have often become so serious that the relief institutions can do no more than alleviate the very worst symptoms of the disease. Borrowers first try to keep going on their own for as long as possible. If these borrowers had been traced at an early stage of the developing problem, effective measures could have been taken sooner.

The step from this theoretically available and practically desirable possibility for the development of an early warning system to the everyday practice of providing credit is a large one. Among other things one is confronted with the thorny problem of the borrower's privacy. It is inconceivable and undesirable that the lender should place the borrower under legal control during the term of the credit.

However, one could reason that the lender's responsibility for checking the borrower's payment ethics and accountability extends over the entire term of the credit and is not confined to the moment when the credit agreement is concluded. In practice there may be points at which it is possible to intervene in a developing problematic debt situation at an early stage; namely at those moments when the borrower makes contact with the lender and sends signals about his personal financial situation. These may be a request for extra credit, the raising of a second or third credit, the extension of the term of the credit, the possibility of carrying out an interim BKR check, indications provided by the borrower's giro payment transactions, etc.

2. A second aspect relates to the acceptance policy of financial institutions, in particular the use of credit-score systems. The investigation has revealed that fewer problematic debt situations are encountered with financial institutions which employ a credit score system than with institutions which do not do so. It should, however, be underlined that those differences are not spectacular. Nevertheless, the use of such a credit score system to assess clients' credit worthiness is to be recommended.

The following remarks should be borne in mind in the realisation of such a system.

In most credit score systems use is made of statistical discriminators. By this is meant that the credit worthiness of applicants for credit is assessed on the basis of group characteristics, such as sex, age, education, occupation, type of housing, and telephone ownership. The only criterion for the inclusion of a characteristic in such a system is the statistical predictability. The use of group characteristics results in applicants being granted or

refused a credit without a direct relationship being established with the applicant's individual financial behaviour.

Taking the characteristics "education" as an example, the possibly negative consequences of working with statistical discriminators, i.e., with group instead of individual characteristics, can be made clear. Taken as a whole there is a positive link between knowledge of institutions and forms of credit and the level of education: the higher the level of education, the greater the knowledge.

In most credit score systems a smaller number of points are given for a low educational level than for a high one. Borrowers with a low educational level are thus more likely not to be accepted. This survey has revealed, however, that persons with low education and very little knowledge, who are *aware* of their lack of knowledge, are not so likely to get into financial difficulties. These applicants with a higher educational level who have a *moderate* factual knowledge (setting aside other factors) have a far greater chance of getting into financial difficulties. Nevertheless, in present practice, the latter would be given a higher credit score.

The investigation has shown that the occurrence of problematic debt situations is also influenced by the financial behaviour and psychological characteristics of the individual. This shows that the indicators which are commonly used in constructing credit score systems do not lead to the formation of homogeneous categories of consumers.

For the prevention of problematic debt situations it is thus desirable that in drawing up the acceptance norms more attention should be paid to the individual characteristics of the applicant for the credit. Possible problems with privacy can be avoided in practice, we think. It is also quite conceivable that the provision of tailor-made credit would be seen as a positive development by borrowers and their representatives.

The result of giving more consideration to individual characteristics of the applicant in the credit acceptance process may be a reduction in the number of both erroneous acceptances and erroneous non-acceptances. This would therefore serve more than just the interest of individual consumers.

3. The investigation reveals that the most important explanatory factor for the origin of a problematic debt situation is institutional, namely the granting of credit to borrowers who already have one or more outstanding credits, either in the form of a second or third credit or in the form of a transfer of credit. Further investigation is needed into why people who ask for extra credit have a greater chance of getting into financial problems.

For the time being some restraint in the granting of additional credit to borrowers who have already taken out one or more credits is to be recommended. If such a credit is granted, it should be based on a careful investigation of borrowers' ability to repay and the reasons for the

application for extra credit. The need for extra credit in itself might be a signal of (future) financial problems.

4. The fourth aspect relates to the impact that personal advice could have on borrowers' behaviour and level of knowledge. The behaviour observed in taking out credit(s) indicates that many consumers do not behave rationally. This is evident, for example, from the fact that many consumers have been mainly, if not exclusively, interested simply in obtaining the credit and to get it fast. No information was sought about the really important credit characteristics such as the term, the interest rate, and the form of the credit.

It seems that many borrowers have as it were delegated the decision about the conclusion of the credit to the lender; they have assumed that the costs of the credit could not possibly create a problem, simply because they have been able to obtain the credit. This is illustrated by those borrowers who, after being refused by one or more institutions, have "shopped around" for a lender who would react positively to their request for credit. It is significant that the judgement of the "rejector" is considered to be less relevant than the judgement of the provider of credit.

The findings relating to the level of knowledge of borrowers are also important in this connection. There is not a simple but a curvilinear relationship between the level of knowledge and the probability of running into financial problems. Borrowers with a very high or very low level of knowledge of credit affairs have a low probability of experiencing financial problems. The former because they can take rational decisions themselves, the latter because they recognise their lack of knowledge and because they want to be sure that they can afford the contractual repayments. In other words, they are budget-oriented. Most problems occur among borrowers with a moderate knowledge. They overestimate their knowledge, therefore do not ask for more information and as a result take the wrong decisions.

Incidentally the latter characteristic holds for a fairly considerable section of the borrower population. If the random sample figures are re-weighted according to the population from which the sample has been drawn, it appears that of the 1,550,000 borrowers (in 1980), 42% or over 650,000 borrowers had a relatively slight knowledge. Of these 650,000 borrowers with a slight knowledge, there were over 280,000 who did not recognise that for themselves and thus overestimated their knowledge.

These findings are relevant for the information and advice policy of government, financial institutions, and consumer organisations. It may be expected that those who have the greatest need for information are the most difficult to reach with advice, since they overestimate their knowledge and will therefore less readily appreciate the usefulness of obtaining information. This category of consumers, with an above-average chance of getting into difficulties, will be difficult to reach with general information.

The effect of stating an interest rate, be it the effective or the nominal

rate, or any other form of price indication for the credit product, must be seen in the light of these findings. This does not mean, however, that such information should be omitted. On the contrary, the statement of an interest rate is a necessary, if insufficient, condition for the consumer to be able to make a good and responsible choice between the credits offered on the market.

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ZUSAMMENFASSUNG

Art, Ausmaß, Ursachen und Konsequenzen problematischer Verschuldungssituationen von Verbrauchern. Der Beitrag berichtet über die wichtigsten Ergebnisse einer niederländischen Untersuchung aus den Jahren 1980 und 1981. Ziele der Untersuchung waren die Ermittlung der tatsächlichen Zahl von Kreditnehmern in einer problematischen Verschuldungssituation und die Beantwortung der Fragen, wie die problematische Situation entstanden ist und welche Konsequenzen sich für die Kreditnehmer und ihre Familien ergeben.

Der eine Teil des Projektes richtete sich auf die Untersuchung der Art, des Ausmaßes und der Ursachen problematischer Verschuldungssituationen, der andere Teil auf die Untersuchung der Konsequenzen solcher Situationen.

Zur Erklärung des Entstehens problematischer Verschuldungssituationen wurden institutionelle, sozioökonomische, persönlichkeits- und verhaltensbezogene Variable herangezogen.

Die Ergebnisse der Untersuchungen sind ein Anstoß, die bisherige Politik zur Vorbeugung von problematischen Verschuldungssituationen zu überdenken und zu verändern. Vier Ausgangspunkte für eine solche Veränderung werden diskutiert. Der erste Punkt bezieht sich auf die Vorhersagbarkeit solcher Situationen und die Einrichtung eines Frühwarnsystems; der zweite Punkt bezieht sich auf die Geschäftspolitik der Kreditgeber; der dritte Punkt schlägt vor, die Vergabe zusätzlicher Kredite an Kreditnehmer, die bereits einen oder mehrere Kredite genommen haben, zu begrenzen; der vierte Punkt schließlich schlägt eine Beratung der Kreditnehmer mit dem Ziel vor, deren Informationssuche und Kenntnisstand zu verbessern.

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