What Can Financial Ratios Tell Us About Low-Income Households?

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This study described the characteristics and financial ratios of low-income households to determine whether or not they are solvent, accumulating assets for the future or spending more in current consumption. The sample was drawn from the 2001 Survey of Consumer Finances (SCF). A total of 830 households had incomes below 200% of the poverty threshold. Of those, 306 had incomes that were at or below 100% of the poverty threshold (lower income group) while 524 had incomes that were between 100% and 200% of the poverty threshold (higher income group).

Among the lower income group households, 63.03% had a positive net worth, while 18.46% had a negative net worth and 18.5% had zero net worth. Of the higher income group households, 83.33% had a positive net worth. Among this group, about 13% had a negative net worth and just over 3% had zero net worth. So just over 20% of the sample had zero or negative net worth. This group was younger, on average, than the two income groups so they have had less time to accumulate assets and may be using more debt in their younger years to accumulate these assets. In addition, this group was more likely to be divorced. While we cannot determine whether there were positive assets prior to divorce it may be possible that assets might have been "lost" as a result of divorce or financial problems as indicated by the zero or negative net worth might have precipitated marital disruption. But also, this group indicated that they were less likely to save on a regular basis than those with a positive net worth.

Analyses of the four financial ratios, debt-to-asset, tangible-asset-to-net worth, investment assets-to-net worth, and net-worth-to-assets, was undertaken using GLM. Since ratios could not be calculated for those households with zero or negative net worth, they were not included in the analyses. Adjusted means controlled for educational attainment, marital status, employment status, race and ethnicity, age, and number of children. Ratio guidelines were based on personal financial management textbook recommendations and empirical research.

The recommended ratio for debt-to-asset ratio is less than 1.00. The lower income group households had an adjusted mean of .176 with a range of 0.00 to 0.953. The higher income group households had an adjusted mean of .225 with a range of 0.00 to 0.994. Both income groups' debt-to-asset ratios were less than the recommended guideline, but surprisingly the group with the higher income does not have the lower ratio. It is possible that the higher income group may qualify for debt when the lower income group may not. The higher income group was more likely to be married, have higher educational attainment, and greater labor force participation, thus making them more credit worthy.

Neither income group's tangible-asset-to-net worth ratio was in the recommended range of less than .50. Those households with lower incomes had an adjust mean of .630 with a range of zero to 20.933 while the adjusted mean for the higher income households was .669 with a range of zero to 35.405. Both groups were below the recommended investment-assets-to-net worth ratio of greater than or equal to .50 with .096 for the lower income group and .394 for the higher income group. Based on the results of these two ratios, low-income individuals may be more present than future oriented. They may value current consumption of material possessions more than planning for the future and may also seek immediate gratification.

Both income groups had a very good net-worth-to-asset ratio with the lower income group having the best ratio, .824 for the lower income group and .775 for the higher income group. Although this is a good ratio, based on the other ratios, most of their net worth is made up of tangible assets which could not be easily liquated if necessary.

Acknowledgments

We would like to express appreciation to Dr. Yoko Mimura, Research Associate, for her computer programming support and statistical support. This research was supported by the United States Department of Agriculture through the Georgia Agricultural Experiment Station.

Endnotes

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