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PoP Briefing Note # 9

Portfolios of the Poor: Three-Country Analysis

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How do the world's poorest households manage their financial lives on $1 and $2 a day? The authors of Portfolios of the Poor tracked the earning, borrowing, spending, and saving practices of 250 households in Bangladesh, India, and South Africa. The resulting "financial diaries" reflect a mixed-research methodology that is systematic in data collection, and simultaneously captures the complexity of people's lives. This brief takes a closer look at the research samples from all three countries.

The Financial Diaries Approach

The Bangladesh diaries, led by Stuart Rutherford, posed a very simple question that had never been satisfactorily answered: do poor people have financial lives? Rutherford focused on the range of financial instruments they used, trying to tease out the trajectory of every penny that went through financial manipulation, and find out why households made the choices they did. In India, Orlanda Ruthven sought to understand financial lives in the context of the livelihoods of the households that used them, and to do so she collected more detailed income and expenditure data alongside the financial data. In the South African diaries, Daryl Collins shifted the emphasis to the quantitative, in order to subject the data to a broader range of financial analysis, creating a system that allowed an expansion of the sample size to the point where statistical analysis became more feasible. To create the diaries, researchers recorded financial transactions and used this data to create household-level balance sheets and cash-flow statements. It's important to note that these are not "diaries" in the true sense, as instead of relying on the householders to record transactions themselves, researchers employed a team of skilled interviewers to record the transactions during fortnightly home visits.

The Portfolio Households

Research was collected from households living in urban and rural communities. In Bangladesh, 21 rural households lived in three adjacent hamlets in rural north-central Bangladesh. The urban sample (21 households) lived in three slums close to Dhaka. Rural diarists (28) in India lived in eastern Uttar Pradesh, a north central Indian state, and the urban diarists (20) lived in three settlements in Delhi. In South Africa, rural diarists lived in Lugangeni, a village located about an hour away from Mount Frere in Eastern Cape. The urban sample came from two major cities in South Africa: 49 households lived in a township outside of Johannesburg, and 45 lived in a township outside of Cape Town.

Table 1. Demographics of the Portfolio Sample (US$ converted from local currencies at market rates)

Country	# of Households	Location	Annual Income		Employment & Locational Demographics
			Median	Range	
Bangladesh	Rural: 21	Three hamlets in north-central Bangladesh	$740	$420-1,799	Low literacy levels; homes were mud-walled and –floored with thatched or tin roofs; most owned the land on which their home was built, but the majority had no or very little agricultural land
	Urban: 21	Three slums in Dhaka	720	380-2,100	All had migrated from rural areas; most held casual or self-employed jobs; most were landless; many were illiterate; the poorest were the elderly
India	Rural: 28	Two villages in Uttar Pradesh	497	241-2,611	One third earned farming income; one third did not educate their children.
	Urban: 20	Three settlements in Delhi	637	171-2,404	All had migrated from rural areas; half had family members still living in rural area; wealthiest respondents had regular salaried jobs.
South Africa	Rural: 58	Lugangeni (Eastern Cape)	2,090	238-49,982	Most owned their homes; all inherited homestead land; most children educated; most adults literate.
	Urban 1: 49	Outside Johannesburg	3,919	504-23,337	Half had regular jobs; 75% lived in one-room shacks; 25% lived in government homes
	Urban 2: 45	Outside Cape Town	3,919	504-23,337	Casual laborers; lived in former rental stock houses; some lived in the backyard shacks of these homes

MicroSave - **Offices in**: Kenya, Uganda, India and Philippines
Email: Info@MicroSave.org Website: www.MicroSave.org

FAI - NYU Wagner Graduate School, 295 Lafayette Street, Second Floor, New York, NY 10012-9604
Website: www.financialaccess.org; www.portfoliosofthepoor.com

Sources of Income

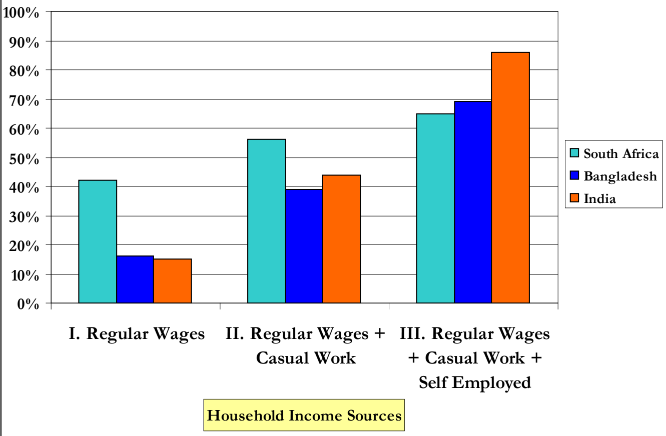
To understand financial strategies, the authors first traced cash flows back to their source, which in part was some form of earnings. In order to understand differences in employment between the three countries, the authors categorized earning activities into three tiers: (I) regular wages from salaried jobs; (II) regular wages plus casual work, such as minding someone's store or doing farm work on an irregular basis; and (III) all types of income-earning activity. Figure 1 illustrates the kinds of employment the authors encountered and reveals key differences between South Asia and South Africa. In South Africa, over 40 percent of diarists enjoyed regular wages, rate two or three times higher than in South Asia.

This margin declines when the definition is widened to include casual work. This illustration also reveals that in South Africa, 65 percent of the adults who could be earning income in some way are managing to do so, whereas this figure is more than 85 percent in India, and nearly 70 percent in Bangladesh. The "triple whammy" of low income, irregular and unpredictable income, and a lack of appropriate financial tools, was clearly demonstrated in the experiences of the diarists (See Triple Whammy Briefing Note).

Mixed Financial Toolkit

While the *Portfolios* sample cannot represent every poor household in the world, the commonalities between the 14 locations in the three countries studied are striking: every diarist used savings and loans products in some way, and all employed a variety of financial instruments to "push" and "pull" amounts far greater than their year-end net worth. The authors defined "push" as depositing, lending, or repaying; and "pull" as withdrawing, borrowing, or accepting deposits. The sum of money being pushed into instruments and pulled out of them represented total household "turnover." The high level of turnover, illustrated in Figure 2, is particularly surprising when considered in relation to income. This "cash flow intensity of income" ratio reflected the sum of funds borrowed, paid out, recovered, deposited and withdraw, divided by household income.

Figure 1. Income-earning categories of financial diaries households. Share of financial diaries adult individuals within each category (percent).



In general, the authors found that the flows moving through financial instruments were large relative to income, even in households with low incomes and small balances. In Bangladesh, where rural incomes were lower than urban ones, median turnover in the countryside is nevertheless higher than in the town.

Average household turnover in India was between 0.75 and 1.75 times income, and reached nearly 3.0 among small rural traders. Turnover was slightly more intense in South Africa, at about 1.85 times income, and the poorer half of the households turned over a bigger multiple of their income than the richer half. This is despite the fact that many of the richer households were wage employees and had their wages paid into bank accounts from which they would then withdraw cash, inflating the value of turnover. Households in all three countries used at least several formal and/or informal financial mechanisms, which they employed regularly, even when they had access to microfinance institutions (MFIs). These products are outlined below.

Saving

The authors observed that most of the large sums in South Africa (75 percent) were raised by building up savings, partly in bank accounts but mostly in informal savings clubs—a distribution attributed to the country's less-developed microfinance sector. Savings clubs involve members making a small, regular contribution to a communal pot, and eventually receiving a large lump sum. This helps mobilise small, steady flows, transforming them into one usefully large sum. Three forms of savings clubs were featured in the South African profiles: saving-up clubs, rotating savings and credit associations (RoSCAs), and accumulating savings and credit associations (ASCAs). These products are detailed in the South Africa Briefing Note.
The entire Bangladesh sample reported employing some type of saving mechanism—either at home or with neighbors. Informal savings clubs in Bangladesh and India were similar to those found in South Africa, and used by many of the diarists, though generally not as often or as successfully as in South African. Sometimes borrowing would masquerade as savings. A major finding of *Portfolios of the Poor* is that microfinance customers often prefer to "borrow to save" (see Borrowing to Save Briefing Note), because the payment discipline provided by microfinance loans

is stronger than among savings clubs.

Fig. 2. Year-end Financial Asset Values and Annual Cash Flows through Financial Instruments for the Median Household in Each Country Sample.

	Bangladesh		India		South Africa	
	Year-end Asset Value	Annual financial turnover	Year-end Asset Value	Annual financial turnover	Year-end Asset Value	Annual financial turnover
Rural	$57	$568	$18	$590	$220	$3,447
Urban	$74	$547	$169	$810	$792	$6,264

While virtually every diary household saved at home, saving-at-home strategies were not wholly sufficient, evidenced by *all* diary households reaching out to their community to bolster their capacity to manage their finances. The authors noted that this approach complemented saving-at-home efforts, since interest-free borrowing and lending was, in effect, a way of harnessing the savings power of a settlement or family to meet the cash flow challenges of its individual members. To tap into these networks required network membership, thus, the resulting "portfolios" reflect financial transactions *and* personal relationships. While better-off individuals may manage daily expenses with a credit card, the poor households observed in this study routinely turned to each other, using one-on-one lending and borrowing between friends, family, and neighbours.

Borrowing

Overwhelmingly, loans were taken locally in the "informal market." In Bangladesh, 88 percent of all borrowing deals were informal, a figure that climbs to 92 percent for the poorest part of the sample. In India, 94 percent of all borrowing was informal, which, again, climbs to 97 percent among the poorest respondents. The use of interest-free informal loans was particularly high in Bangladesh relative to the other two countries studied. The authors reported that the pro-poor microfinance sector in South Africa was relatively small, although some groups, such the Small Enterprise Foundation, were growing steadily. While the entire Bangladesh sample reported saving in some way, when compared to sums formed through savings, sums formed through loans outnumbered savings by a ratio of four to one.

In the first set of Bangladeshi diaries (1999-2001), MFIs reached 30 of the 42 diary households. Despite this widespread use of microfinance, however, it proved to be a relatively small part of households' overall financial activity: microfinance products accounted for only 13 percent of all household financial assets, and 21 percent of debt. The second set (2003-2005) showed progress on this low figure, largely attributed to advancements in loan top-up mechanisms, increases in the variety of both short and long term savings products, and improvements in the reliability of products. See Portfolios of Bangladesh's Poor Briefing Note for more details. In India, microfinance is expanding rapidly, though the country's poor remain largely un-served by MFIs. In the 1990s, India's social banking sector joined the movement, lending to groups of women organised in jointly liable "self-help groups", allowing India's banks to reach an additional 11 million families by 2005. Grameen Bank "replicas" in India reached 10 million customers in 2007, an increase of 3.1 million from the previous year. More recently, the Indian government has ordered banks to offer "no frills" accounts as part of its financial inclusion policy. These accounts reduce the paperwork needed to open an account and eliminate the minimum balance requirements that had previously kept poorer customers away. Although such progress is in no way trivial, the number of un-banked poor in India remains in the hundreds of millions. These are major triumphs of the sector, but microfinance's still relatively small share of the total transactions of poor households indicates the need for further microfinance product innovation.

Insurance

The financial diaries illustrated a clear contrast between the paths of private life insurance schemes in India and Bangladesh. Pre-dating the successful Indian model, "pro poor" life insurance products in Bangladesh were an attempt by the private sector in the 1990s to target poor populations in a manner very similar to that of the rapidly growing microfinance sector. The high proportion of Bangladeshi diarists in the 1999-2001 study enlisted in these schemes reflects their initial popularity. In theory, these schemes were meant to serve both as safety nets in the event of a death of a family member as well as a mechanism for long term savings. However, efforts by companies to design products that could be delivered cheaply to poor populations meant that normal safeguards were overlooked. Additionally, despite being private, formal, and regulated, many of the private life insurance products proved unreliable. Management of these schemes began to unravel, with poor bookkeeping, fraud, nepotism, and agents visiting areas irregularly. This behavior resulted in many of the diarists losing substantial sums of money. The financial diaries chronicle both the initial growth and the dramatic descent of the "pro poor" private insurance sector in Bangladesh. Debt forgiveness upon death, or "credit-life" insurance, is offered to most microfinance clients in Bangladesh. The payment for these schemes is often built into the price of the loan. The authors found it available to nearly half the Bangladeshi sample. Some providers have gone beyond this basic form of insurance and offer payouts on the death of any current client, or of her husband, irrespective of her loan or savings status.

South Africa's degree of wealth, robust social service sector, and pervasiveness of HIV/AIDS translated into a research sample divergent in important ways from the South Asian portfolios. The South African sample exhibited the highest inequitable distribution of household earnings, which allowed insight into the financial lives of better-off households. This was true in the urban sample especially where few lived on average incomes of less than $2 a day, and about 40 percent lived on more than $10 a day. These urban households, however, were poor or very poor by local standards. South Africa's free health clinics and government grants (the main source of income for 27 percent of the sample) meant that diarists were, in theory, better equipped to manage emergencies and serious illness than households in Bangladesh or India.

Funerals in South Africa, however, continued to pose a continual and substantial drain on households' resources, particularly with the high prevalence of HIV/AIDS. Funerals were paid for by combining resources from a variety of sources, including payouts from funeral insurance. Three types of funeral insurance were documented among diarists: (1) Formal Insurance—regulated financial companies collected monthly premia and at time of death, offered a cash lump sum payout (26 percent of households held at least one plan of this sort); (2) Funeral Parlor Coverage—similar pay-in practices to formal insurers, but at time of death, the parlors provided a fixed set of goods and services, and sometimes a lump sum of cash to the bereaved (24 percent of households held coverage with parlors); and (3) Burial Society Policies-administered by local groups, members paid into a joint bank account and at time of death, relatives received a payout of cash and/or in-kind contributions. At least 80 percent of diary households had at least one funeral insurance scheme, and most respondents had more than one.

Major Expenses

Table 2 outlines three very general categories of the uses of large sums accumulated by diary households. "Emergencies" include all sudden-onset occurrences that threatened life, health, or property; "life-cycle" uses reflect household consumption, as well as expenditures on births, marriages, and deaths; and "opportunity" expenses ranged from asset accumulation to debt repayment.

Table 2. Primary use of 298 Large Sums

Use of sum	Bangladesh Number	Bangladesh Percentage of total	India Number	India Percentage of total	South Africa Number	South Africa Percentage of total
Life-cycle	22	23%	42	30%	17	26%
Emergency	6	7%	6	4%	11	17%
Opportunity	66	70%	91	66%	37	57%
Total	94	100%	139	100%	65	100%

Emergencies

The lack of systemic insurance tools available meant that diarists were unable to respond to emergencies with tailor-made large sums. Instead, emergencies were met with a mosaic of smaller loans, savings, and asset sales. In Bangladesh, microcredit loans were seldom available for emergencies because they were disbursed on an annual cycle that prohibited pre-payments. Strikingly, around 42 percent of the Indian diarists faced health related crises which ranked as the largest drain on their existing financial resources. Health issues are problematic for numerous reasons: treatment is often a large expense relative to income; employment and the ability to generate income are usually jeopardized; and the critical need to pull together adequate financing at the *right moment,* can have disastrous financial consequences. In all, however, emergencies accounted for a rather small share of the total expenses documented over the research year.

Life-Cycle

Life-cycle events provide a motive for saving, one that Princeton economist Angus Deaton terms "low frequency" saving because the events are generally predictable well in advance and savings strategies can be put in place without requiring substantial revision. In India and Bangladesh, weddings were by far the most common expensive "life-cycle" event. In South Africa, most households held specialist tools designed to produce large sums for the most common costly life-cycle expenditure there—funerals.

Opportunities

The authors observed that most of the larger sums were spent to seize opportunities of various sorts. A very common use for lump sums is buying land and buildings, though these investments tended to be perceived differently in diary households in South African than in those in India and Bangladesh. In South Africa, the rural land populated by low-income households is rarely seen as a financial investment, but rather one that is made in order to fulfill cultural obligations and desires. But in both India and Bangladesh, land is a fast-appreciating store of wealth, and the motive behind investing in land in these two countries is most certainly economic.

Lessons from the Portfolio Approach

The portfolio approach shows the power of well thought-out partial solutions, and the need for improved product design to better meet the needs of poor households. *Portfolios* uncovered three areas in which microfinance providers can better help the unbanked, including helping poor households: 1) manage money on a day-to-day basis; 2) build savings over the long term; and 3) borrow sums for all uses.