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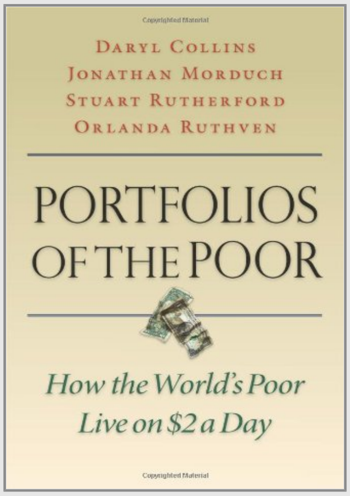

Portfolios of the Poor

How the World's Poor Live on $2 a Day

Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven
Princeton UP © 2010
296 pages
Book: getab.li/25534

Rating

9

9 Importance
9 Innovation
8 Style

Focus

Leadership & Management
Strategy
Sales & Marketing
Finance
Human Resources
IT, Production & Logistics
Career & Self-Development
Small Business
Economics & Politics
Industries
Global Business
Concepts & Trends

Take-Aways

- In 2005, according to World Bank figures, 2.5 billion people lived on less than $2 a day.
- Impoverished people's meager incomes arrive irregularly.
- The world's poor rarely spend all their money as soon as they earn it.
- In a poor household, annual cash flow is usually much larger than the year-end balance.
- The poor manage money via a complex array of "formal, semiformal and informal" financial instruments that reasonably represent "portfolios," however meager.
- They carry out most transactions through informal channels rather than banks.
- They frequently use small, interest-free loans and neighborhood saving clubs.
- Such informal instruments offer flexibility, but not always reliability.
- Microfinance institutions – "financial services for poor people" – are now growing at remarkable rates.
- Microbanks should offer more flexible loan and saving products.

Relevance

What You Will Learn
In this summary, you will learn: 1) How the world's poor survive on meager, erratic incomes and 2) How microfinance providers could tailor money-management tools to the poor's day-to-day financial needs.

Review
The World Bank said in 2005 that 2.5 billion people live on less than $2 per person, per day. Researchers Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven say the poor rarely spend all the money they get. After using financial diaries to track the day-to-day monetary activities of more than 250 households in Bangladesh, India and South Africa, the authors report that the poor are active money managers who handle relatively large cash flows and usually build savings into their "portfolios." The authors believe international development efforts should provide poor households with better financial tools for managing their current incomes. The authors describe the challenges and strategies of impoverished households, and paint academically restrained – but still touching – portraits of individual families. *getAbstract* recommends this meticulous research and its conclusions to international development workers, microbankers, nongovernmental organization officials and social entrepreneurs. Microfinance providers will find guidance to tailoring products to fit the complexity of poor people's lives.

Summary

Impoverished People Learn to Be Efficient Money Micromanagers
In 2005, says the World Bank, 2.6 billion people lived on earnings of less than $2 a day, and about 40% of them scraped by on about a dollar. You might expect people in such straits to spend every penny as soon as they get it, just to keep a roof over their heads and food on the table.

"A daily income of less than $2 per person has become a widely recognized benchmark for defining the world's poor."

You might conclude that the best antidote is to raise their incomes through charity or global industry. Yet when you examine the financial lives of the poorest households, you find a different picture. The poor are active money managers who employ a dizzying array of mostly informal financial instruments to manage their "portfolios," stretch their meager earnings and build savings.

A long-term policy focus on income is important, but policy makers and advocates should push for initiatives to support poor families' money management. Access to reliable financial tools would let the poor immediately reduce the unpredictability and risk in their lives.

The Poverty Study
Starting in 1999, a team of researchers tracked the financial activities of more than 250 rural and urban households in Bangladesh, India and South Africa. They spent a year in each country and followed up with a further three-year survey in Bangladesh. In contrast to conventional short-term studies, which focus on tracking families' year-end balances, this study followed day-to-day cash flow over the long term.

"The money that the poor earn too often arrives at the wrong times, can be hard to hold onto, and is difficult to build into something larger through borrowing and saving."

The data offered surprising findings. All the households studied managed cash flows many times larger than their year-end assets. None of them spent every cent as soon as it came in. Every family held some sort of savings and debt balance. They all used at least four different types of financial-management tools, such as neighborhood savings clubs, informal loans and store credit.

"Unreliability in financial tools reinforces other areas of vulnerability in the lives of the poor."

"The Triple Whammy"

The poor work hard on managing their money because their meager resources must meet three financial goals:

1. **Stretching income to fund daily needs** – They need to provide food and shelter and to meet such expenses as doctor visits or school fees.
2. **Planning for emergencies** – They have little access to insurance or "social safety nets" for financial emergencies like injury, death and income or property loss.
3. **Raising lump sums** – Families need larger amounts to buy household goods, invest in property or business opportunities, or to pay for weddings or other social occasions.

Financial Challenges

The poor must negotiate three interrelated obstacles:

"The people best placed to help – neighbors and family members – are typically poor themselves."

1. **Low incomes** – In Bangladesh, survey households' annual incomes ranged from $380 to $2,100. In India, the range was $171 to $2,611; in South Africa it was $238 to $49,982.
2. **Uncertainty** – Poor households have no predictable income. The $2-a-day figure is an average: Workers may earn more on some days, less on others and for – stretches of time – earn nothing. In rural India, for instance, farmers and traders encounter seasonal fluctuations in their work.
3. **Unreliable financial tools** – The informal financial transactions that poor people most rely on do offer flexibility and convenience, but they are often unreliable. Potential transaction partners are equally poor and may lack the cash to offer aid. Informal saving arrangements are vulnerable to dishonesty or poor discipline, and loan terms are usually not dependable or clear.

Current Financial Tools

"Many poor households...manage to create substantial sums in their financial instruments."

Most households used a patchwork of financial mechanisms to smooth out the unpredictability of their earnings and to save for emergencies or large expenditures.

In Bangladesh and South Africa, the average household used almost 10 types of instruments. Indian respondents averaged slightly more than eight. One Bangladeshi family – Hamid and Khadeja and their child – lived on the equivalent of $70 a month and built up reserves in six financial instruments, including a $40 loan to a relative, a $2 cache hidden in their home and $76 in life insurance.

The financial tools that poor people in India, Bangladesh and South Africa use include:

"Interest-free borrowing and lending is in essence a way of harnessing the savings power of a neighborhood or family network to address the cash-flow problems of its individual members."

- **"Interest-free loans"** – Relatives or neighbors give each other small, interest-free loans, sometimes with the expectation that the debtor will reciprocate in the future. During the survey year, one Bangladeshi rickshaw driver took out five such informal loans in two months. They were for $4 or less; he repaid them quickly.
- **Moneylenders** –Moneylenders charge an annual interest rate of as much as 200%. Most households use moneylenders only for loans of a month's duration or less. Households turn to moneylenders in emergencies or when they need cash on short notice.
- **Microlenders** – Microfinance providers traditionally offer small loans to poor clients for business investment. Recently, they adapted their products to meet a wider range of needs. Survey households in Bangladesh tended to use microlenders for larger loans.

- **"Savings clubs"** – Members make regular contributions to these small neighborhood groups. After a fixed interval, they share the lump sum. The group can be a simple "saving-up club" in which members contribute regularly and then split the total at the end of the year. Variations include the "rotating savings and credit association," in which a different member takes the balance each month. A third type is an "accumulating savings and credit association," which allows members and nonmembers to borrow interest-bearing loans. At some point, the club closes and the members each get a share of their contributions and the accumulated interest. Savings clubs have several drawbacks. Most are short-term and are only as reliable as their members: Clubs can fail due to dishonesty or because individual members can't keep up with their payments.
- **Ad hoc saving** – All the households in the study made some effort to save, usually at home in a lockbox or in some hidden corner. Keeping money at home can be risky due to theft or the temptation to spend it.
- **Money guards** – A money guard is a relative or neighbor who protects money. The poor also hire "roving deposit collectors" who keep money safe for a fee.
- **Shop credit** – Poor households often obtain groceries on credit or take an advance on their wages.
- **"Money sharing"** – People may agree to share wages and other payments that arrive at staggered intervals. For instance, some families in South Africa create sharing agreements around the receipt of grant payments to children, the elderly or the disabled. A monthly payment schedule is too infrequent for people managing day-to-day, so people who receive payments on different days of the month lend a portion of the grants to each other to level out the peaks and valleys of their monthly schedules.

"Poor households are frustrated by the poor quality – above all the low reliability – of the instruments that they use to manage their meager incomes."

"Convenience, flexibility and reliability are at the heart of building workable financial tools for the poor and are a key to understanding the economic lives of poor households more broadly."

Improving Financial Tools

Before they can work on long-term goals, such as rising out of poverty, poor households must focus on day-to-day "cash-flow management." Low-income families need flexible financial tools to meet daily needs and replay loans on time. They place less importance on the reliability of the tool than on its flexibility.

"When specialized instruments – formal or informal – are unavailable or insufficient, emergencies are addressed by selling assets, drawing down savings and borrowing."

A few high-quality flexible instruments can help the poor improve their lives. For instance, if insurance companies offered alternatives to informal, unreliable "insurance clubs," poor people would have an option for meeting emergencies other than depleting their savings, going into debt or selling their few assets. Some organizations offer a savings or credit package that incorporates life or health insurance. However, selling comprehensive health insurance is chancy because such plans require premiums the poor cannot pay. Organizations could devise cheaper, more limited plans, such as insurance that pays for prescription drugs.

The Role of Microfinance

Grameen Bank – which economist Muhammad Yunus, the Nobel Peace Prize winner, started in 1976 – opened the door for poor people to work with formal financial institutions and gain access to reliable financial instruments. Now microfinance is growing at an exceptional rate. By 2006, Grameen had more than six million impoverished customers. In time, microfinance institutions came to supply "more than half (almost 56%) of the disbursed value of all loans taken by these households, though all of them also borrowed from one or more other sources. This is a considerably bigger proportion than the 38% in the original 1999–2000 Bangladesh diaries."

"Where financial tools are not available, the result can be emergency asset sales; in the worst cases, those sales strip households of the means to earn future income, triggering a downward spiral toward destitution."

Originally Grameen focused on microcredit loans for small businesses. The bank and its competitors broadened their scope by providing savings accounts and insurance policies.

The credit side of the business still focuses on fostering small business. Grameen and similar banks in Latin America, Asia and Africa have modified their practices to accommodate the uncertainty of poor people's everyday finances.

"The world's poor constitute an enormous and largely untapped market for goods and services, a next frontier for retail business."

Grameen expanded its range of loans to include terms from three months to three years. It softened its original, rigid repayment schedules to allow small weekly or monthly installments. With another of Grameen's innovations, customers can "top up" their loans. For instance, if you borrowed $200 and repaid $100, you could borrow another $100 and continue paying the original loan for a longer term. You can borrow repeatedly without sinking further into debt; you merely reset to the original value of the loan. India's banks introduced flexible crop loans via the "Kishan Credit Card." Customers can borrow at any time and pay the amount back on their own schedule, if they pay their balance by the end of each year.

Opportunities for Microfinance

Survey data suggest that microfinance institutions provide the most opportunities in three areas:

"Being poor does not disqualify you from being inventive in your finances."

1. **"Cash-flow management"** – Poor households would welcome a service that simplifies their effort to stretch irregular earnings to cover day-to-day expenses. It should offer small-scale savings of any amount with the right to deposit or withdraw any time. It should also offer small loans at any time and give debtors a flexible payback schedule.
2. **"Building savings"** – Poor people must save for the long term, a need that banks could help them meet by offering "long-term contractual savings products." Such instruments would offer the convenience of savings clubs but reliability and a longer savings term.
3. **Loans** – Poor people seldom secure loans large enough to handle big-ticket purchases, emergencies or social events like weddings. Many microbankers still focus on lending for business investments, but "general-purpose loans" could become the single largest market that banks find among impoverished people. Many poor families take out loans in lieu of insurance. They are reluctant to buy insurance to cover emergencies, because they know that most of what they insure against will never come to pass. Instead, they would prefer being able to withdraw loans to cope with emergencies.

"If you're poor, managing your money well is absolutely central to your life."

The Financial Future

The poor live with constant uncertainty. They must contend with sporadic incomes and cope daily with a host of unreliable institutions – the police, the courts, and health and education agencies. Microfinance brings reliability to the financial activities of the poor. Their definition of "reliable" is not elaborate: They want institutions that keep their promises, maintain accurate records and never demand bribes. The poor turn out to be surprisingly adept at stretching small sums of money amid unpredictable circumstances and with unreliable tools. When they have access to higher-quality tools, they will plan and economize even more effectively.

About the Authors

Daryl Collins is a senior associate at Bankable Frontier Associates. **Jonathan Morduch** teaches public policy and economics at New York University. **Stuart Rutherford** is a founder of the microfinance institution *SafeSave*. **Orlanda Ruthven** recently completed a doctorate in international development and works on youth employment and labor standards in India.