Savings and the Poor[1]

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Do poor people save?

An individual's capacity to translate day-to-day financial decisions into adequate savings and investments for future financial needs depends on fulfillment of several constraints such as (1) knowledge, skills and ability to make financial decisions towards a secure financial future; (2) having access to and understanding the advantages of using formal banking institutions; and (3) awareness about personal behavioral biases and attitudes towards financial management. While the rich and the poor both have to work hard at overcoming these constraints to build that financial safety net, common misconceptions persist about the saving habits of the poor. For example (1) poor have insufficient and irregular cash flow and savings, (2) poor do not have the discipline to save due to lack of self-control and temptation spending, and (3) informal savings institutions[2] are not a viable solution for the poor. Research however indicates otherwise; not only do poor households save based on their income levels, they usually save in small amounts throughout the year, withdrawing savings for lumpy and large expenditures for life events and emergencies; and the poor regularly use diverse informal savings channels in absence of formal ones despite the risk of losing a portion of savings to expensive fees, fraud or theft (Karlan & Morduch, 2009; Rutherford, 1999).

A CMF-IFMR study conducted in five urban and semi-urban cities of India (Kc, 2011) found that a majority (75%) of existing MFI clients saved using different formal and informal saving mechanisms[3]. 60% of these respondents relied almost exclusively on their personal savings to finance unexpected expenditures they faced three months prior to the survey. Another CMF-IFMR study conducted in Assam (Das, 2010); found that poor often turned to risky savings products and services offered by unregulated informal financial intuitions, in absence of safe formal ones offered by banks. Such informal institutions are frequently managed by local service providers, who collect savings from members on a daily or weekly basis, in return for a fee. Unlike banks, which don't provide flexible solutions for small and irregular savings by the poor, these institutions allow clients to save from Rs 5 to Rs 150 per day. Rutherford (1999)

[1] The shorter version of this article appeared in Ideas for India – Link: http://www.ideasforindia.in/ArticleTypeSrc.aspx?article_id=96+&articleType=Article

[2] Informal practices consist of interest and non-interest generating practices. Examples of informal institutions in India are Chit Funds, ROSCAs, deposit collectors etc.

[3] Regulations do not permit Non-Banking Financial Corporation (NBFC) Microfinance Institutions (MFIs) to offer clients formal savings products or services.

found that women in urban slums of Vijaywada (Andhra Pradesh) saved as little as Rs 5 daily with deposit collectors to ensure savings at home are not squandered away. In return women gave up part of their savings as fees, earning a -30% APR on their savings. Additionally, the poor also use semi-formal savings instruments such as Rotating Savings and Credit Associations, moneylenders, or depositors are used in rural and urban settings, though these saving institutions are riskier and often more expensive than the banks.

Are poor people reluctant to save with the formal financial mainstream?

Insufficient financial inclusion, knowledge and awareness about the formal financial sector are often touted as reasons for low take-up of formal financial products and services by the poor (RBI Report, 2012). To address the issue of access to formal banking institutions, the Reserve Bank of India (RBI) initiated the 'National Pilot Project for Financial Inclusion Plan' (NPPFI) in 2005 to remove cost barriers via No Frills Accounts (NFA) or zero balance accounts; improve delivery channels through the Banking Correspondents (BC); and utilize mobile banking to facilitate transactions and expand coverage (NABARD Report, 2007). In addition, states governments are experimenting with ways to increase formal savings by adopting default savings options, which can "nudge" people to save and subsequently reduce temptation spending (Karlan & Morduch, 2009). For example, some state governments have tried to increase access to formal savings accounts by mandatorily delivering all wages to participants in National Rural Employment Guarantee Act (NREGA)[4] through formal saving accounts (MoRD-GoI, 2005).The financial inclusion policy also recommends cooperative societies, post offices and Self-Help Groups to mobilize formal savings devices for the poor (NABARD Report, 2007).

However, financial access does not always equate to usage, as many recipients of these financial services do not actually use them or understand their purpose. In CMF-IFMR study conducted in rural households of Andhra Pradesh (Johnson, Meka, 2010) found that even though 78% of rural households had access to a formal savings account, the vast majority of accounts (79%) were opened either to receive government benefits or to increase the chances of receiving a loan, but not for voluntary savings. In another stark example, several reportedly 100%-financially-included districts in India have been demonstrated to have active-no-frills accounts usage of less than 25% (Ramji, 2009; Thyagarajan & Venkatesan, 2008).

This low participation rate and take-up of formal financial services and products could be because of clients' limited awareness and understanding about financial instruments, and their perception that banks may not accept their small and sporadic savings. Behavior economists

[4]NREGA aims at enhancing the livelihood security of people in rural areas by guaranteeing hundred days of wage employment in a financial year to a rural household whose adult members volunteer to do unskilled manual work

also suggest that the poor are reluctant to use the formal institutions because they might find the banking system unfamiliar, threatening, or stigmatizing, creating perception that he or she is not a valued customer at the bank (Bertrand et.al, 2006).The poor also find banking procedures cumbersome, for example, a CMF-IFMR study conducted in rural Andhra Pradesh found that 49% that procedure related to opening an account, such as having little knowledge about banks and their products, not having proper documentation required for opening an account, banking fees and expenses, and so on, as reasons for not using formal savings account (Johnson, Meka, 2010).Though the Microfinance sector has tried to fill-in where banks have left-off by connecting the unbanked population to mainstream finance, regulatory restrictions forbid many forms of Micro Finance Institutions (MFIs) to provide savings services to the poor (MFI Bill, 2012).

Need of the hour: Design and marketing of products to suit the needs of the poor

Several studies indicate that the poor turn to informal savings products because (1) there is either an absence or a significant constraint to formal financial institutions; (2) informal institutions provide flexibility and convenience, given the sporadic and relative smallness in savings amounts by the poor; (3) unlike the seemingly burdensome and complex process instituted by the banks to open savings accounts, poor can easily opt into timely and relatively uncomplicated informal savings products; and (4) informal savings devices are often provided by someone known to the client such as neighbours or local depositors etc., garnering a sense of trust in personal relationships. Therefore, while formal savings products provide a safer and cheaper mechanism to save, informal savings products have their inherent advantages which appeal to the poor when conducting savings transactions. To ensure the shift happens to safer formal financial products to achieve the financial inclusion policy directive, savings products must therefore be developed to lower the constraints currently being experienced by the poor, while simultaneously being flexible and accommodating of the savings needs of the poor. As Dean Karlan states we need to think beyond *"will this lead people to save more" but rather "will this relax a particular constraint, or lower a particular cost".*

Savings products impacting the underlying behavioural factor influencing savings have been tested and manipulated through product design, and the product take-up and usage have been encouraging. For example, an experiment found that commitment savings products and default savings options may help reduce frivolous and temptation spending (Karlan & Morduch, 2009). Studies conducted in Philippines (Karlan et.al, 2011)and Malawi (Brune et.al, 2011)showed that commitment savings accounts were effective in increasing savings. A small experiment by CMF-IFMR[5] encouraged a small-group of low-income respondents to commit to save a minimum amount once a week for any three weeks over a 6-week period, where they had access to a formal savings channel. Respondents set a savings goals, and committed to save with no penalties charged for default by writing a promise to self or making an oral promise in presence of the administrator of the exercise or making an oral promise in presence of their colleagues. Though the experiment provided no financial product, and just a promise to save, take-up rate was encouraging at 73%, with 17% respondents saving per their commitment in the first week.

[5] Findings from the pilot study will be published in CMF-IFMR's January newsletter edition

Another study found that for clients who may be inattentive to savings needs, or are overly optimistic about their future savings, specific reminders associated with expenditure (or savings goals) are especially useful (Karlan, 2011). In Peru, clients who received specific expenditure reminders, increased savings by 6% compared those who received no reminders; comparatively, non-specific reminders had no significant impact on savings. This could be because "mental accounting" plays an important role during savings - where people seem to physically or mentally compartmentalize expenditures into various categories and save accordingly (Mullainathan & Shafir, 2009). Additionally, messages from a third-party have been shown to work better than self-generated messages because messages seem official in nature and establish a sense of trust in the clients (Karlan, 2011). Studies also show that the take up of the product only increases if there is strong relationship between the client and the channel used for information dissemination. For example, CMF-IFMR found that an endorsement by a trusted local NGOs increased take-up of insurance product by 10.4% (Cole et.al, 2009). Thus, the design, delivery and marketing of savings products need to be compatible with the savings needs and address the behavioural constraints faced by the poor.

Recommendations

1. First, products must be designed to lower the psychological constraints the poor face when accessing formal savings institutions. We recommend that in India, greater awareness campaigns will be useful in promoting savings. Banks should be marketed to the poor to highlight that formal banking not as institutions for borrowing only but as institutions for savings. The banks can use several campaign strategies such as public announcements with the help of trusted local governance institutions, simple instructional flyers encouraging people to open an account to save etc. To increase take-up, products must have add-on features such as reminders, and basic literacy about the products features. Additionally, product enrolment procedures should be simpler, transparent and convenient. In India, relaxing Know Your Customer (KYC) guidelines might accommodate larger section of the population as many clients do not have the required documents.

2. Secondly, deriving from the theory of behavioural economics and findings from various studies, we recommend designing of modified (soft) commitment savings device that is flexible enough to accommodate the unsteady and varied savings preferences of the poor. A pilot study conducted by CMF-IFMR indicated that savings products with no penalties, and the client's verbal or written promise to save, found encouraging take-up rates. Default savings options must be introduced where possible to further reduce barriers to savings. These studies highlight that a small tweak in product design can encourage the take-up of formal savings products. We recommend that such experiments with a varied range of commitment saving products require further exploration.

3. Thirdly, we recommend that products delivery should not be cost-prohibitive for the provider. Providing flexible formal savings products are often cost-prohibitive for formal

institutions and technology can help increase take-up and usage of these products. For example, the Jipange Ku Save (JKS) model directly deposits client's small interest fee loans into the client's M-PESA mobile wallet, with one-third of the principal held back as savings. Though just in a pilot phase, initial assessments show this technology enabled savings, and majority of clients (77%) started repaying at least some portion of their initial loan within two months. Repayments are also done using mobile technology reducing transaction cost for providers. In the Indian context, RBI must encourage financial institutions and mobile providers to test such innovative savings products that benefit the client, and are also profitable for service providers. In India, the RBI has proposed that banks use the services of NGO/SHGs, MFIs and other civil societies (excluding NBFCs) as intermediaries in providing financial and banking services through the usage of Business Facilitators (BFs) and Business Correspondents (BCs). CMF-IFMR study found[6] that even though this model has an immense potential in promoting financial inclusion in India, the agents are struggling to make their business profitable and financially sustainable as the current commission structure is not adequate to cover agents' costs. In addition, the study reports that agents are facing issues with cash management and liquidity due to unwillingness to share risks by both BCs and banks. Thus, the Government must promote the adoption of innovative savings products with appropriate technology to address the supply shortage of well-designed formal savings products.

4. Lastly, we recommend that the definition of financial inclusion must be re-addressed by the Government of India. The informal financial sector meets the savings needs of the poor by offering timely and flexible products and services. Therefore, the role of the informal financial providers should not be completely written off from the financial inclusion mandate. Instead, the favourable features of informal financial products and services must be adopted by the formal financial institutions, and the RBI should work towards regulating and monitoring the major informal financial providers through better fraud or theft reporting and remediation, better returns on funds deposited by members, and opportunities for linkages with the bank by converting groups into SHGs where possible.

[6]Yet to be published but findings have been discussed at CMF'IFMR's blog "Analyzing the Business Correspondent model" http://centreformicrofinanceblog.blogspot.in/2012/10/analyzing-business-correspondent-model.html

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