Improving People's Lives Through Savings

Jake Kendall, Bill & Melinda Gates Foundation
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The work of the Financial Services for the Poor initiative is based on the belief that the poor need financial tools, including safe places to save. Better savings options help the poor build themselves up and make investments in their future, as well as make themselves less vulnerable to being knocked back down when they have a medical crisis, lose a job, or suffer through a drought. The available evidence tells us that while the majority of poor people are unbanked, their informal financial options are often inadequate for many of their financial needs and the lack of access to formal financial services is often a major hindrance to meeting their financial goals.

Most Poor People Are Unbanked or Underbanked

Estimates indicate that 2.9 billion adults, or half the world's adult population, are unbanked, and 2.7 billion of them, or 90 percent, are from low- and middle-income countries.[1] Household surveys in developing countries consistently find very few have a bank account, often less than 20 percent of households.[2]

The few poor people who do have access to financial services are often poorly served. Many clients open a formal savings account only to find them too costly or inconvenient to maintain.[3] In Ghana, a time use study found that 70 percent of the women surveyed used informal deposit collectors who charged 5 percent per month for their services, as opposed to only 36 percent who were willing to walk 4 km on average and spend 45 minutes in line to make a deposit in an interest bearing account at a local bank.[4] Of course, neither of these choices is a good option. In South India, financial inclusion drives succeeded in getting many clients to open accounts, but these new customers often never used them because the bank branch was too far away or they had not been instructed on how to use the account by the bank.[5]

The Poor Need Financial Tools

In addition to having precious little income to begin with, the poor often have highly variable and uncertain income and few financial options to help them cope with emergencies, make investments, or simply buy groceries on days when their income is low. Two of the primary needs the poor face are to build up lump sums for investment and generate cash in a hurry for an unexpected need or emergency. Often the poor borrow to meet these needs, but interest rates may be more than 200 percent per year. Additionally, the authors of the book, *Portfolios of the Poor*, found that households used between eight and 10 different types of mostly informal financial instruments with very high turnovers—often 10 times the asset values through the year and more than 100 percent of their income. This reveals a remarkable resourcefulness, but when transaction costs don't scale with transaction size, fragmenting transactions over many informal instruments can be very costly. Therefore, they not only need financial tools, they need *well-performing and cost-effective* financial tools.

Evidence suggests that the poor are active savers. Researchers regularly measure that the percent of their income consumed is less than 100 percent, with the rest being saved or used to pay back loans.[6] When queried in surveys, the poor often report savings accounts as their greatest financial need. For example, in 2006 FinScope Uganda found that 43 percent of respondents said savings is their greatest financial need, compared to 31 percent who cited credit. The poor save actively at home in cash and through informal mechanisms. For example, rotating savings and credit association (ROSCA) membership rates among the adult population have been estimated at between 50 percent and 95 percent of adults in the Democratic Republic of Congo, Cameroon, Gambia, villages in Liberia, Ivory Coast, Togo, and Nigeria.[7] Most importantly, when given a compelling option, the poor take up formal saving products in great numbers and often at greater rates than they take up other financial services. In Indonesia, BRI bank attracted 10 times as many savings clients as borrowers when it revamped its savings product line, and similar ratios have been observed elsewhere among lower-income clientele.[8]

Informal Savings Methods Are Inadequate

In the absence of formal savings accounts, the poor resort to informal methods, such as hiding cash under a mattress, investing in livestock or jewelry, or saving through an informal deposit collector or club—methods that do not always serve their needs well. Some researchers have found that most informal savings options lack the privacy needed to keep others from demanding or borrowing a person's savings for their own needs, as well as the self-discipline needed to encourage saving.[9] Others have noted that informal options can be high risk and unreliable, breaking down when needed most.[10]

Without sufficient savings available for emergencies such as an illness or injury, or to fund major purchases and investments, the poor often resort to borrowing from moneylenders charging high interest rates or they may simply go without.

Formal Savings Accounts Can Help the Poor Improve Their Lives

There has been limited research on the impact of savings on the lives of the poor, but what is there finds evidence that savings accounts help the poor save up and invest in their future as well as withstand emergency needs for cash without depleting their other assets, such as business inventory. One randomized field study found that women given access to savings accounts were investing 45 percent more in their businesses (mostly in inventory) than were women who were not given accounts, had 27 percent to 40 percent higher daily expenditures, and were less prone to sell business assets to deal with health emergencies.[11] Another study found that "commitment" savings accounts empowered women to make more of the economic decisions in the household, while another found that giving farmers the option to store their money in the form of fertilizer vouchers increased investments in fertilizer by 39 percent at planting time.[12] Similar to the fertilizer voucher study, new results coming from a study in Malawi show that farmers given commitment savings accounts that allowed them to lock up their harvest proceeds until the next planting season have increased their farming investments by 64 percent, leading to 54 percent higher farming proceeds and 31 percent higher post-harvest consumption.[13] Other studies have found significant increases in savings, reductions in poverty, and increases in economic activity when bank branches move into an area.[14]

The Next Steps

Affordable, convenient access to a trusted place to save their money has the potential to improve the lives of the poor. The poor have shown that they have the capacity to save by repaying debt and saving informally, request formal savings options when asked, and take them up in great numbers when given a viable option. Rigorous field studies have shown that access to a savings account can help the poor save to make productive investments leading to increased consumption, can help weather bad times, and can even increase female empowerment. Nevertheless, the poor often need to rely heavily on informal savings options that do not always meet their needs.

Despite the potential of savings accounts, very few of the poor have them. New, second generation banking business models raise the possibility of reaching these underserved households with new financial products, but there are still many challenges. Recent data from Kenya show that the M-PESA mobile product has been taken up by more than 70 percent of households—including more than half of the poor, the unbanked, and rural households in the country—and is being used more and more as a savings tool. Additionally, preliminary analysis shows that having access to the M-PESA product improves families' welfare by increasing their ability to deal with risk.

As we go forward, we need to better understand the fundamental value proposition that savings accounts represent for the poor. As a start, we need better data on the financial needs that can best be met with savings, the fundamental advantages of formal accounts over informal ones, the account features (such as commitment) that are most impactful, and the ways in which having an account improves welfare for different groups. We also need to understand the poor's perceptions of the value of savings services so that commercially viable savings products can be created and marketed to the poor effectively.

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[3] "South African Financial Diaries and the Mzansi Initiative: Five Years Later," Bankable Frontiers Associates (2010). http://www.bankablefrontier.com/assets/pdfs/BFA%20Mzansi%20Financial%20Diaries%20revisits%20160210%20FINAL.pdf.

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[6] Daryl Collins, "Stocks and Flows – Quantifying the Savings Power of the Poor", Focus Note, www.financialdiaries.com (2005); Dale W. Adams, "Mobilizing Household Savings through Rural Financial Markets," Economic Development and Cultural Change, vol. 26, no. 3 (1978); Robert M. Townsend, "Risk and Insurance in Village India," Econometrica, Vol. 62, Is. 3 (1994). http://ideas.repec.org/a/ecm/emetrp/v62y1994i3p539-91.html.

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[9] Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven, *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton: Princeton University Press, 2009).

[10] Graham A.N. Wright and Leonard Mutesasira, "The Relative Risks to the Savings of Poor People," MicroSave (January 2001); Stefan Dercon, "Risk, Crop Choice, and Savings: Evidence from Tanzania," Economic Development and Cultural Change, Vol. 44, No. 3 (1996).

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[12] Esther Duflo, Michael Kremer and Jonathan Robinson, "Understanding Technology Adoption: Fertilizer in Western Kenya Preliminary Results from Field Experiments," MIT, Harvard University, and Princeton University (May 2004). http://www.econ.berkeley.edu/users/webfac/saez/e231_s06/esther.pdf.

[13] Brune, Gine, Goldberg, and Yang (2010)

[14] Robin Burgess and Rohini Pande, "Can Rural Banks Reduce Poverty? Evidence from the Indian Social Banking Experiment," London School of Economics and Yale University (June 9, 2004), http://www.hks.harvard.edu/fs/rpande/papers/dobanksmatteraer_rr1.pdf; Miriam Bruhn and Inessa Love, "The Economic Impact of Banking the Unbanked, Evidence from Mexico," Policy Research Working Paper 4981, The World Bank Development Research Group, Finance and Private Sector Team (June 2009), http://ideas.repec.org/p/wbk/wbrwps/4981.html; Fernando Aportela "Effects of Financial Access on Savings by Low-Income People," working paper, Banco de México Research Department (December 1999), http://www.lacea.org/meeting2000/FernandoAportela.pdf. Though the evidence presented often hints that improving savings options are generating the impacts, these studies find it impossible to conclusively determine whether the increased lending, savings mobilization, or both are responsible for the effects observed.