Getty Images

by Daryl Collins,
Bankable Frontier Associates,
and Jonathan Morduch,
New York University

Reimagining the Unbanked

Perspectives from South Africa

Attempts to broaden financial access in poor communities usually take one of two directions.[1] The first is providing credit to small-scale microenterprises, an idea pioneered by Bangladesh's Grameen Bank. The second involves fostering long-term saving for education, housing, or other worthy goals.[2]

But low-income families usually have a more fundamental financial need, one that families often pay dearly for: basic, reliable ways to manage cash flow.

The Importance of Cash Flow

When families lack ways to cope with the ups and downs of income and expenses, they may turn to predatory lenders or to friends and relatives with little of their own to spare. Basic cash-flow management is the foundation for families seeking to make the most of what they have.

We draw on evidence generated by *financial diaries* that detail the financial lives of 152 households in three low-income communities in South Africa.[3] The diaries tracked the households every other week between November 2003 and December 2004. The respondents did not keep a diary themselves. Instead, field researchers asked them detailed questions about their families' financial flows during the prior two weeks: did they take out a loan, deposit money into an account, take goods on credit?

Drawing lessons from South Africa for the United States might not at first appear reasonable, given that the latter is a much wealthier country, with a gross national product (GNP) per capita of $28,000, nearly three times South Africa's. Still, the wide income disparities in both countries mean that the lowest-income households in the United States have income and asset levels relatively similar to those covered in the South African diaries. On average, the diary households have an annual income of $12,400, measured on the basis of purchasing-power parity.[4] The 2004 *Survey of Consumer Finance* reports that the mean income for U.S. households below the 20th percentile is $10,800.[5]

There are certainly distinct conditions that affect South African low-income households, most centrally South Africa's pre-1994 legacy of apartheid and the post-1994 emphasis on black economic empowerment that continues to shape the economic landscape. Additionally, South Africa's official unemployment rate is about 30 percent. In contrast, the U.S. labor market is much tighter, and there is a large population of working poor. However, despite these differences, both U.S. and South African households have similarly low incomes and exist in the context of a sophisticated financial system that does not always adequately address their needs.

Households that Surprise

What we learned contradicts some common beliefs about low-income households and their financial management, showing that people do manage and save their money. We also found that the common insistence on lending geared only toward productive

investment, such as microenterprise, misses much of what households need to support the realities of daily life.

Constant Financial Management

The households we studied were active financial managers. The assumption that low-income households lack financial lives gets the reality backward. Precisely because incomes are low, people devote considerable energy to strategizing about finances. In the South African sample, households used an average of 17 different financial instruments over the year in their financial portfolios. They juggled financial relationships with banks, other financial institutions, and with friends and family. All mechanisms, taken together, are needed to provide the kinds of reliability, flexibility, and discipline that households demand.

Consider Sylvia, a disciplined 39-year-old woman living in a shack in Diepsloot, outside of Johannesburg. She earns about $370 per month as a housecleaner for two separate clients.[6] Her income puts her at about the average for her community. Every month she has her employers put her pay into two different bank accounts. One she uses for all her expenses; the other she tries not to touch. Keeping two accounts entails extra bank fees, but it gives her a mechanism with which to save half her salary every month—a mechanism in keeping with the notion of "mental accounts" prominent in behavioral economics.[7] Sylvia also contributes to a formal college savings plan for her daughter and to five informal savings clubs organized by neighbors, a financial device common across the developing world.[8] She is not without debt: over the course of the year, she worked to pay off two credit cards she had used the past Christmas. Like all the respondents in our study, Sylvia manages a portfolio of financial activities, borrowing and saving with a diversity of financial instruments. She is, however, one of the better money managers—more than doubling her financial net worth over the year.

Active Saving

A low income does not mean lack of aspirations. The South African households had financial goals similar to ones seen in better-off households, particularly with regard to acquiring a home and paying for events like weddings, funerals, and holiday celebrations. On average across households, 26 percent of monthly income went into savings instruments—primarily bank accounts and informal savings clubs—to attain those goals. However, because incomes were small (an average of $1,040 per month, converted at purchasing-power parity rates), savings represented a small absolute amount of $270 per month. More important, these small amounts were usually not given an opportunity to accumulate for more than one year before being diverted to short-term needs or unexpected events, the implication being that it is harder to accumulate money for the long term.

When unexpected events did hit, households augmented savings with funds from a variety of sources, none of which were cost-free. They borrowed at informal rates of 30 percent per month. Assets sold in emergencies hampered income generation and financial protection later on, and help from family and friends was not always forthcoming. Likewise, when an unexpected opportunity arose, such as the chance to start a business, there was rarely enough saved up to take advantage of it. Finding ways to convert short-term accumulations into a pool of accessible savings was thus a continuing concern.

Need for Flexible Borrowing

In both developed and developing countries, "consumer finance" often carries negative associations. In the United States, that is because of associations with predatory lenders and extreme credit card debt. In poorer countries, it is due to tales of exploitative moneylenders. So policymakers tend to be more enthusiastic about credit for productive purposes like microenterprises.

But the households we studied were more likely to need consumer finance than microenterprise loans. Even loans that were nominally made to support small businesses were often diverted to other purposes. In South Africa, low-income households may use loans to cope with health shocks, pay for school fees, put food on the table, or participate in communal and religious activities. The choices households made suggest that they need access to credit for flexible purposes. That is why the conversation on microcredit is too narrow. A good first step would be to reimagine consumer finance in a more constructive light—without dismissing the serious and ongoing concerns about overindebtedness and predatory lending.

Looking Forward

Low-income South African households actively manage finances, save money, and seek lending beyond business finance. These three findings suggest that the financial lives of the poor are not much different from the financial lives of richer people. That is why moving away from a strict focus on asset building toward improving access to basic banking services may be a better way to help low-income but savvy money managers get what they need to improve their lives.

Daryl Collins *is senior associate at Bankable Frontier Associates in Somerville, Massachusetts, and* **Jonathan Morduch** *is professor of economics and public policy at New York University.*

Endnotes

1. This essay draws heavily from Daryl Collins and Jonathan Morduch, "Banking Low-Income Populations: Perspectives from South Africa," in eds. Michael Barr and Rebecca Blank, *Insufficient Funds* (New York: Russell Sage Foundation, 2009).
2. Michael Sherraden, *Assets and the Poor: A New American Welfare Policy* (Armonk, New York: M. E. Sharpe, 1991).
3. We proportionately selected households from across the income spectrum in each neighborhood studied. The work described here was part of a collaborative project that also took place in Bangladesh and India. See Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven, *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton, New Jersey: Princeton University Press, 2009).
4. Numbers that are compared directly with U.S. numbers are converted from South African rand to U.S. dollars at the purchasing power parity rate of 2.7. All others are converted at the market exchange rate.
5. All U.S. data quoted here are from the *Survey of Consumer Finance*, 2004, the year that the South African Financial Diaries project was conducted.
6. Names of respondents have been changed to protect identities.
7. Richard H. Thaler, "Anomalies: Saving, Fungibility, and Mental Accounts," *Journal of Economic Perspectives* 4, no. 1 (1990): 193-205.
8. Stuart Rutherford, *The Poor and Their Money* (Rugby, United Kingdom: Practical Action, 2009).

This Communities & Banking article is copyrighted by the Federal Reserve Bank of Boston. The views expressed are not necessarily those of the Bank or the Federal Reserve System. Copies of articles may be downloaded without cost at www.bos.frb.org/commdev/c&b/index.htm.