THE FINANCIAL Diaries

INVESTIGATING THE FINANCIAL LIVES OF THE POOR

DETAILS CAN BE FOUND ON WWW.FINANCIALDIARIES.COM.

FOCUS NOTE: Financial Instruments of the Poor

KEY POINTS:

- Households used, on average, 17 different financial instruments over the course of a year.
- A composite household portfolio, based on all 166 households, would have an average of 4 savings instruments, 2 insurance instruments and 11 credit instruments.
- The same composite household portfolio would have about 30% formal instruments and 70% informal instruments.
- Rural households use as many financial instruments as urban ones.
- A larger volume of transactions went through formal instruments than informal ones, although this is distorted by payroll banking transactions.

There is a strange irony when thinking about financial planning of poor households. One assumes that by the very nature of not having money, the poor cannot possibly work to manage what they do have. However, empirical facts do not support this assumption. In Financial Diaries surveys in both Bangladesh and India,[1] it was found that the poor tend to manage their money through a variety of financial instruments. In the South African Financial Diaries, the same was found to be true.

The Financial Diaries survey traced the daily income, expenditure and financial device usage for 166 households over the course of one year.

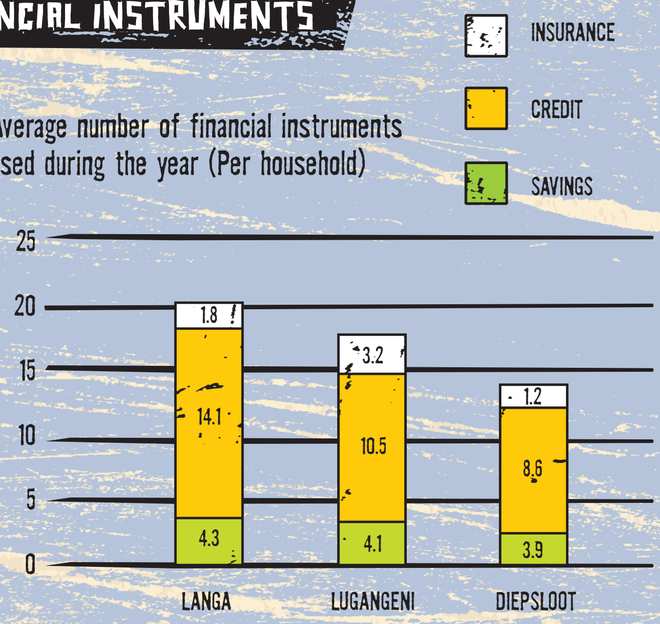
[1] Rutherford, S (2002): "Money Talks: Conversations with Poor Households in Bangladesh about Managing Money". Paper No. 45, Finance and Development Research Programme Working Paper Series, Institute for Development Policy and Management, University of Manchester.
Ruthven, O. (2002): "Money Mosaics: Financial Choice & Strategy in a West Delhi Squatter Settlement" Journal of International Development 14, 249–271.
Ruthven, O. and Kumar, S. (2002): "Fine-Grain Finance: Financial Choice and Strategy Among the Poor in Rural North India" Paper No. 57, Finance and Development Research Programme Working Paper Series, Institute for Development Policy and Management, University of Manchester.

THE POOR HOLD A PORTFOLIO OF DIVERSE FINANCIAL INSTRUMENTS

Over the course of the study year, we found that households would use an average of 17 different financial instruments. Some financial instruments would "stay open" all year – like a bank account – while others would open and close within days, like borrowing between neighbours.

We found that most households used a variety of insurance, credit and savings instruments. The poor do not tend to use only one type of financial instrument – they manage a portfolio. Most households have at least one credit, insurance and savings instruments. They do not just borrow, and they do not just save.

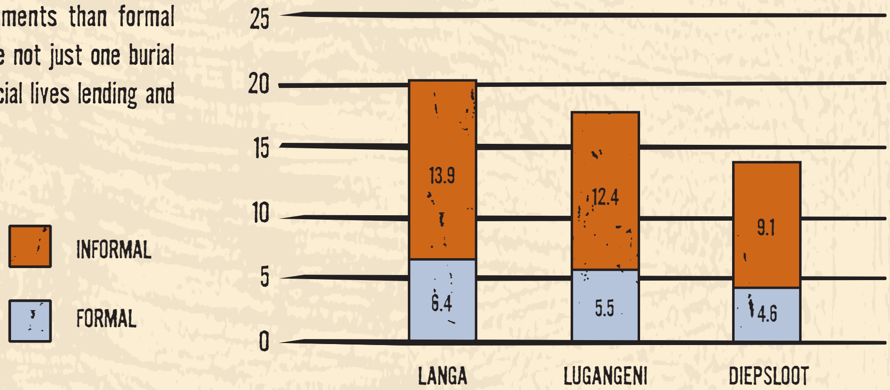
Average number of financial instruments used during the year (Per household)



RURAL HOUSEHOLDS TEND TO USE AS MANY FINANCIAL INSTRUMENTS AS URBAN HOUSEHOLDS

One might assume that, because they are further from formal financial services, the rural poor might use less financial instruments. However, we found that they tend to use as many financial instruments as urban households. They tend to use more informal instruments than formal instruments. One reason for this is because they use not just one burial society but several. They also have very active financial lives lending and borrowing with each other.

Average number of financial instruments used during the study year (Per household)

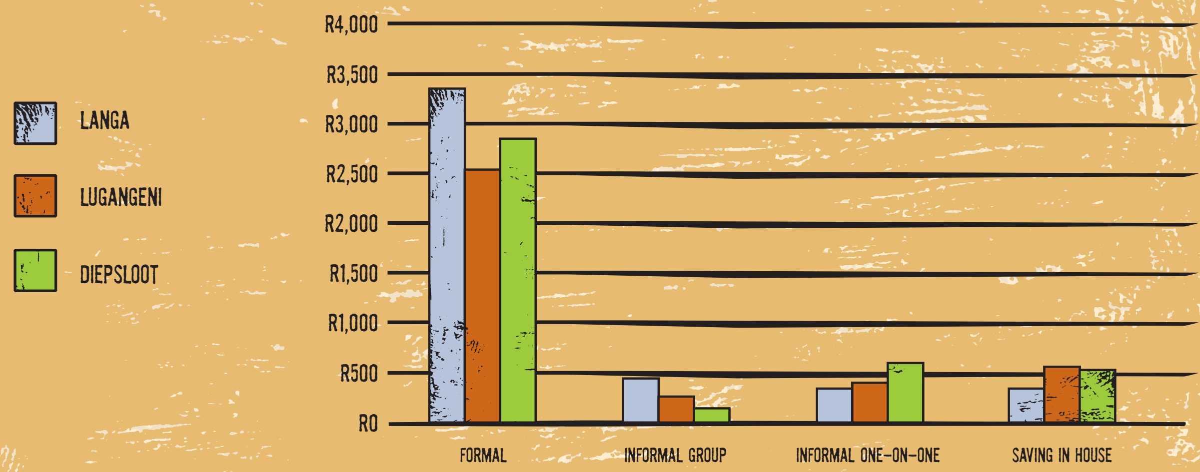


MOST TRANSACTIONS GO THROUGH FORMAL FINANCIAL INSTRUMENTS

All households push and pull a significant amount of money through financial instruments over the course of a month. We capture this activity by turnover. Turnover is calculated by adding the inflows into a financial instrument with the outflows of the same financial instrument over a particular period. In the chart on the next page, we chose to show the month of August as a typical month of turnover in different types of financial instruments.

Overall, the average household in the sample in a typical month will transact about R3000 through financial instruments. Not surprisingly, these transactions primarily happen in transaction-based formal financial instruments such as bank accounts. A household getting a payment through the bank – regular wage, pension or grant–will receive this money into the instrument plus take the same amount out on a typical month. "Turnover" counts both transactions

Monthly* Turnover** for Types of Financial Instruments*** (Rands)

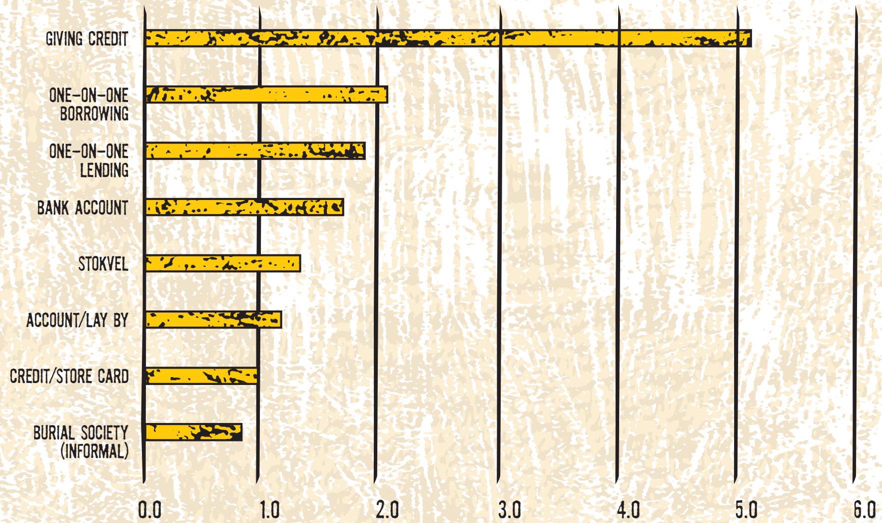


*For month of August 2004
**Turnover = inflows into the instrument plus outflows out of the instrument.
***Formal = Bank accounts, provident funds, formal funeral plans, formal insurance, formal loans, accounts/lay by, store cards, unit trusts and savings annuities.
Informal group = stokvels, burial societies and stokvel loans.
Informal one-on-one = mashonisa loans, one-on-one lending and borrowing and money guarding.
Saving-in-house = savings in house.

LANGA: GIVING CREDIT IS THE MOST FREQUENTLY USED FINANCIAL INSTRUMENT

In Langa, the most frequently used financial instrument is a business giving credit. This is not because there are a large number of businesses in Langa, but it may be because the businesses in our Langa sample have given more credit relative to other areas. A financial instrument is created every time a new customer takes credit and households can have up to 15 credit accounts running at the same time. Next on the list is one-on-one borrowing and lending. The average household in the Langa sample will have borrowed at least twice over the study year from neighbours, friends or family, and they will have lent an equal number of times.

LANGA:
Average Use of Financial Instruments* (Average = Total number/52 households)

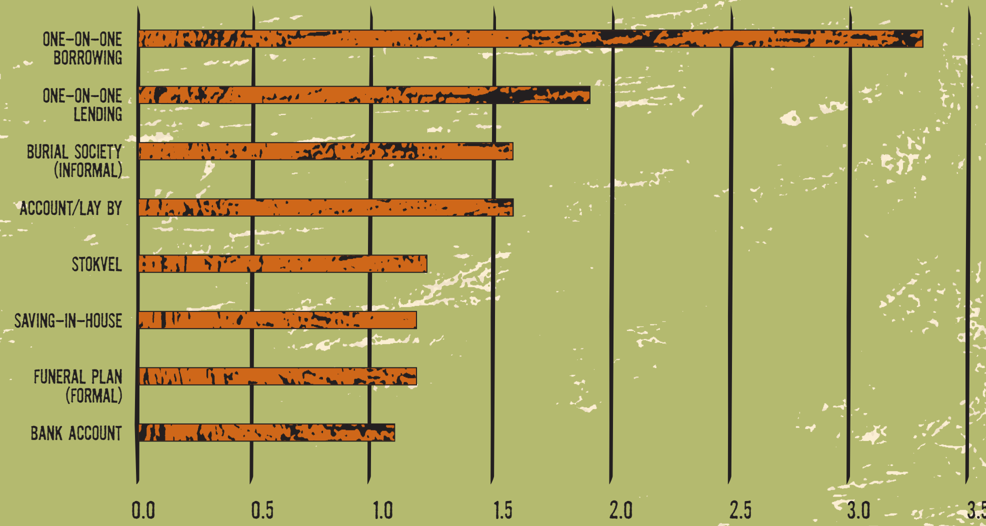


*Only the top 8 instruments are listed – households do use other instruments.

LUGANGENI: BURIAL SOCIETIES ARE FREQUENTLY USED

As in Langa, households in Lugangeni have frequent borrowing and lending patterns between each other. Unlike Langa, Lugangeni households are likely to have at least one informal burial plan, as well as one formal funeral policy. They are also more likely than other areas to save in their houses. Although informal financial instruments tend to be used more frequently, this does not mean that households do not have bank accounts. The average household in Lugangeni will have at least one bank account.

LUGANGENI: Average Use of Financial Instruments* (Average = Total number/60 households)

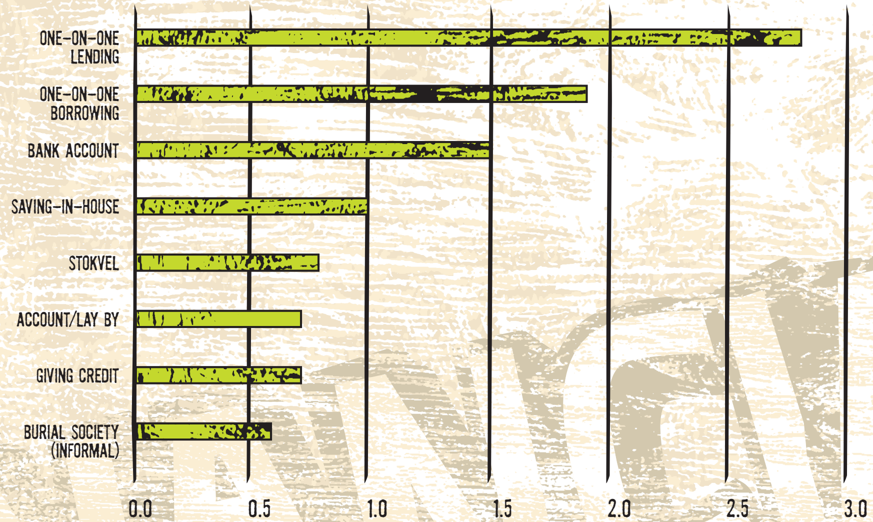


*Only the top 8 instruments are listed – households do use other instruments.

DIEPSLOOT: BANK ACCOUNTS ARE MORE FREQUENTLY USED

Although very few people have lived in Diepsloot for more than a couple of years, financial transactions in the form of lending and borrowing are as frequently used as in the more established areas of Langa and Lugangeni. In Diepsloot, however, households use bank accounts more frequently than the other two areas. The average household will have at least one bank account. Despite this frequent use of banks, however, most households will also save in the house.

DIEPSLOOT: Average Use of Financial Instruments* (Average = Total number/54 households)



*Only the top 8 instruments are listed – households do use other instruments.

FINANCIAL

CASE STUDY 1: Poor rural household with many informal financial instruments

Masiwela* is a neat and gracious 65 year old woman who is living with one grandchild and the child of a relative. She supports the three of them on an old age grant. Her daughter gives her money now and then, but she constantly complains that the old age grant is not enough to support them. She asks her son for money, but he says that the grant should be enough. Another daughter, who receives a child grant, also comes in and out of the household with her two children. In order to cope she often takes goods on credit with local vendors (six times over the year), borrows from mashonisas (twice over the year) and borrows from relatives (twice over the year). She also takes credit from the local spaza shop, and pays it off by the end of the month.

Over the course of the study year, she used a total of 20 financial instruments. She belongs to two funeral plans with local undertakers and also belongs to five burial societies. Three of the five burial societies require payment only when someone dies. However, there have been many funerals to which she has needed to contribute in the past year. As a result, she says that she has had to take mashonisa loans to cover the payments.

Masiwela also has a bank account but she didn't use it during the study year – she says that she only used it when she was younger and working. However, she also said that she is concerned about saving in the house, which she did all year, because her niece lost R50 hiding money in the house.

CASE STUDY 2: Peri-urban household with many formal instruments

Lucas* is a 34 year old man living with his 26 year old wife and 3 year old daughter in a house in Diepsloot. He has a regular job working as a stock control person. Most of his financial instruments are connected with his payslip. He earns a gross salary of R871 per week. Each week, PAYE, union fees and UIF are deducted as well as child support of R75 that he provides for his children by another woman. He owns his home via a home loan and pays the bond off his payslip. A deduction of R131 is made every week. He also pays R175 every week to pay off a loan from his employer, which was borrowed against his provident fund. In addition, he pays Medicare and Discovery Health, as well as an employer-owned provident fund. Lucas's employer gives the employees a statement that shows their balance in the provident fund, as well as how much they can borrow against it! He borrowed R5000 two years ago to buy a fridge. His salary is paid into a bank account every week.

Apart from financial instruments that are connected to his payslip, Lucas also pays R20 per month for an informal burial society from his home village. He also bought a wall unit on account and pays R200 every month for this.

Early in the study year, he grew too ill to work and his employer gave him a gift of R2000 with which he bought a TV. With the exception of the last 1,5 months he was ill, he received sick leave. During the 1,5 months that he did not earn a salary, he was supported by remittances from his relatives.

FURTHER RESEARCH TO COME

- What are the financial usage profiles for different types of households? What is the typical financial instrument portfolio for households with an older household head as contrasted with a younger household head?

- How does regular employment impact the type of financial instruments that households use? Do the more formal instruments that households have access to once employed add value to their financial management?

DETAILS CAN BE FOUND ON www.financialdiaries.com

* Names have been changed to protect the identities of the respondents.