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Research Report

What Use for Flexible Microsavings? Lessons from SafeSave

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What Use for Flexible Microsavings? Lessons from SafeSave

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Abstract

Poor people often recourse to costly savings strategies in order to better organize their financial life. I have observed the use of flexible savings-and-loan accounts by 16,076 poor slum dwellers living in Dhaka, Bangladesh, from January 2004 to August 2012. I find that 59% of them borrow at high interest rates and, at the same time, hold low-yield liquid savings. This policy brief explains that clients who simultaneously borrow and save use debt strategically to protect their income from being sharable with others. Co-holders of debt and savings are more likely to be poor women working in the formal sector, such as garment factories. A potential explanation stems from the fact that these women enjoy regular and visible wages and are therefore subject to financial solicitations by their families and friends. My findings emphasize that co-holding debt and savings can act as a tool for income protection. In this respect, the flexibility of savings is a key feature.

*This Policy Brief is based on an extensive study (Laureti, 2013) and was prepared for the Ferdi conference "Flexible Financial Products in Microfinance to Address Risk", Clermont-Ferrand (France), June 12-14, 2013. The author is grateful to Marek Hudon, Marc Labie and Ariane Szafarz for their valuable comments.

► Introduction

There is increasing evidence that the poor in developing countries are both willing and able to save (Collins *et al.*, 2009). Yet, many of them have difficulties organizing their financial life. The lack of suitable financial products leads the poor to recourse to costly saving strategies. According to the microfinance literature, savings products targeting the poor should include both commitment and flexibility features. Commitment embeds incentives to accumulate savings while flexibility provides liquidity for emergencies.

In Laureti (2013), I observe the daily movements on 16,076 flexible savings-and-loan accounts at SafeSave¹, a microfinance institution operating in the slums of Dhaka. The observation period stretches from January 2004 to August 2012. In total, 9,511 (59%) clients co-hold expensive debt and low-yield liquid savings. This policy brief attempts to rationalize this costly behavior. I oppose two potential explanations: pure liquidity needs and income protection against solicitations from family and friends. The conclusion of this policy brief favors the second explanation.

► 1. The sample

I observe the saving behavior of the 9,511 clients who borrowed from SafeSave at least once between January 2004 and August 2012.² The flexible savings account offered by SafeSave is a no-maturity account with no constraint on deposits or withdrawals. The only restriction concerns the compulsory (part of the) savings required to have access to credit. To benefit from a loan out-

standing balance of X , the client needs to have a savings balance equal to or greater than 33% of X . Loans are repaid freely, with no maturity or fixed installments. Only the interests are due on a monthly basis. Clients pay a 3% monthly interest on loans and earn a 0.5% monthly interest on their savings.

The majority of SafeSave's borrowers are women (83%), and the average borrower is in her thirties. In total, 43% of borrowers declare no professional occupation, with the majority (95%) being housewives. Among those with an occupation, 77% can be categorized as own-account workers or self-employed, who earn their income on a daily basis and often of irregular amounts. In contrast, 23% have jobs or are employed in the formal sector.³ They earn a regular and fixed wage, typically paid on a monthly basis. The vast majority (72%) of the formal sector is made of workers in garment factories.

SafeSave's clients make small and frequent deposits but make relatively large and infrequent withdrawals. The average amount deposited is 62 BDT⁴ while the average amount withdrawn is 910 BDT. On average deposits are made on a weekly basis and withdrawals every 6 months. Similarly, clients reimburse their loans through frequent and small repayments. Clients take out one loan every 2 years on average. The initial loan amounts to 6,086 BDT on average. Repayments are made on a bi-weekly basis, and the average amount repaid is 280 BDT. On average the savings balance is 1,926 BDT, while the outstanding loan is 3,090 BDT. Taking into account the one-third rule for compulsory savings, I estimate that clients have average liquid savings of 896 BDT.

1. SafeSave was created in 1996 by Stuart Rutherford and Rabaja Islam. More information can be found in Laureti (2013) and on www.safesave.org.

2. The sample includes 4 of SafeSave's 9 branches, namely Millat, Muslim, Gonoktuli and Kurmitola. For these 4 branches, the product features are similar for the whole observation period. In particular, the compulsory savings requirements are the same.

3. This occupational category includes "dependant" workers in the sense that they do not own their mean of production. They are for instance rickshaw pullers, construction workers, bus drivers; or they seek to exploit a skill such as barbers, beauticians, mechanics, etc. In contrast, self-employed people own a small business, being for example tea-suppliers, meat sellers, or owners of small grocery stores, laundry shops, or flower shops.

4. The exchange rate was approximately 80 Bangladeshi taka (BDT) to one U.S. dollar over the period of the study.

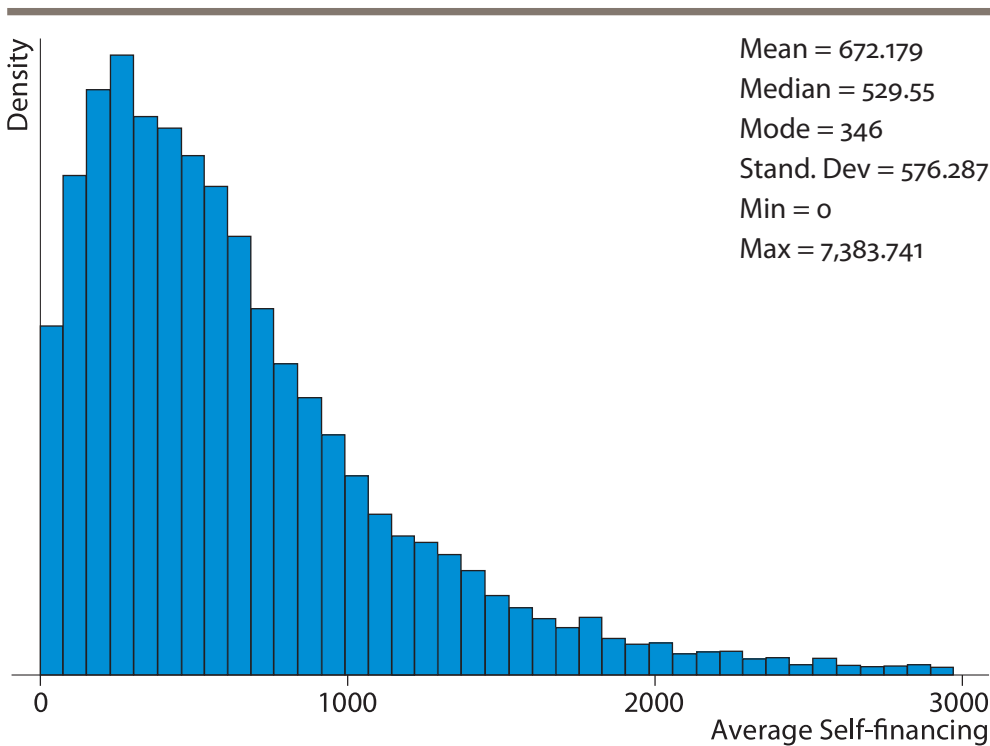
► 2. Self-financing amount

In line with Baland *et al.* (2011), I define a borrower's self-financing amount (SFA) in period t as the existing savings that can be withdrawn to repay the outstanding credit. In particular, SFA is zero when borrowers do not have liquid savings. A non-zero SFA indicates that the borrowers co-hold loans and non-compulsory savings. Co-holding debt and savings is costly. By repaying the loans with the existing savings, clients could save 2.5% monthly interest paid on the self-financing amount.

I have computed a specific SFA for each borrower in the sample by averaging the values

of this amount over the life of the borrower's account. Figure 1 reports the whole SFA distribution. The mean value is 672 BDT, and the median is 530 BDT. The distribution is asymmetric, with a high concentration to the left. This means that many people try to minimize co-holding, albeit imperfectly.⁵ Still, there is a non-negligible share of people who reach a high SFA. For instance, 24% of the borrowers co-hold, on average, more than 910 BDT, the mean amount withdrawn among the group of borrowers. I argue that the excess of self-financing – with respect to the amounts withdrawn – can hardly be explained purely by liquidity-based theory.

Figure 1. Distribution of the average self-financing amount (SFA)



Note: In order to make the graph readable, I have excluded the 62 observations that are greater than 3,000 BDT.

5. This is partly due to the fact that clients are obliged to have some discrepancies during loan repayment because they can take a new loan after having fully repaid the previous one.

▶ 3. Why do poor people co-hold loans and savings?

To understand why some people exhibit high co-holdings while others do not, I investigate the links between SFA and borrower's characteristics.⁶ In particular, I am interested in the correlation between SFA and the volatility of the clients' income. The sign of this correlation allows the distinction of the pure liquidity motive from the income protection motive for co-holding debt and savings. On the one hand, if the liquidity motive prevails, I expect the correlation between SFA and income volatility to be positive. This is because higher income uncertainty would induce higher demand of liquidity for precautionary purpose. On the other hand, if the income protection motive prevails, I expect the correlation between SFA and income volatility to be negative. As argued in the literature (e.g. Salway *et al.*, 2003), siphoning on money for personal expenditure is much harder for clients who receive a regular and fixed income than for those receiving, for example, varying daily earnings.

Because I cannot observe clients' income directly, I consider as a proxy the clients' cash-in (sum of savings deposits and loan repayments). Due to the endogenous cash-in regressor in the SF equation, an endogeneity problem arises. To control for endogeneity, I use an instrumental-variable estimation. The instrument is a binary variable that has a value of one if the borrower has a job/employment – hence, earns a regular fixed income – and zero otherwise.

The regression of SFA with borrowers' characteristics shows that, among clients, women are more likely to be co-holders than men. Moreover, women earning a regular wage – for example, workers in garment factories, home servants, and regular employees in hotels, hospitals or schools – have higher SFA than any other gender/occupation group.

I argue that these women are the savers for whom it is the most difficult to hide their income. First, they depend on their husbands, who could try to seize their revenues from work. Second, the garments factories offer fixed wages, which are well known in the Dhaka working-class community (e.g. Kabeer, 1997). As a result, I contend that co-holders are rational people motivated by the need to hide resources from their community. They recourse to loans in order to have the legitimacy to claim that they need their income to reimburse debt. Literally, this is true. However, by simultaneously compensating loans with flexible savings, they manage to keep a substantial fraction of their income for themselves. Co-holding loans and savings is thus a way to hide resources while keeping easy access to cash.

My results are consistent with the findings of Baland *et al.* (2011). The authors show that individuals in Cameroon take out costly loans they do not really need as a way to signal poverty and avoid requests for financial help from their families and friends. More generally, hiding income is known to be a significant concern in household financial decision-making.

▶ 4. Conclusions

There is increasing evidence that the poor in developing countries value savings and do save. The poor need to save for different purposes. Randomized experiments conducted in developing countries suggest that savings products should be tailored to clients' needs. For example, soft commitment technologies – such as safe boxes, reminders through Short Message Services (SMSs), and savings accounts earmarked for specific purposes – can turn out to be effective to help poor people save. In contrast, commitment products such as rigid savings plans are useful for individuals with strong self-control problems. My sample is composed

6. See Laureti (2003) for the details on the various regression specifications and results.

of microfinance borrowers. Most of them feel the need to save too, and I try to understand why they do so. This policy brief shows that the main motivation to co-hold loans and savings is to protect income against solicitations from family and friends.

This policy brief does not want to make any judgment about whether social norms or sharing obligations are right or wrong. The aim is rather to understand which product features could best respond to the needs of a segment of the poor, namely those who want to protect their own income from being sharable. Flexible savings-and-loan accounts seem to be the proper product for them. Indeed, co-holders demand liquid savings and loans. Liquidity is key for maintaining the possibility of dis-saving in case of emergencies. And the loan is useful for income protection. The major drawback of co-holding loans and savings is the interest rate spread individuals have to pay for this strategy. This is especially true in microfinance contexts where interests on loans are quite high. For example, at SafeSave, the interest rate spread between savings and borrowing is 2.5% on a monthly basis.

Because co-holding loans and savings significantly reduces the probability of default, one could imagine a decreasing interest rate mechanism for loans backed by savings. The reduction of interest rates between savings and borrowing should be done with caution. For example, there is the risk that the new product cannibalizes the market of existing products, resulting in reduced profits for the institution.

Interestingly, SafeSave has recently introduced the P9 product in one of its branches (Rutherford, 2011). The P9 product seems to address well the need of individuals wanting to co-hold loans and savings. It provides liquidity through a cheap credit line while, at the same time, helping SafeSave's clients to accumulate savings. When clients need liquidity, they can take a free-interest loan or top-up an existing loan. "Topping-up a loan" means to have the

capacity to borrow as much as one has repaid. Every time clients borrow some money from SafeSave, half of the loan amount and one fifth of each loan top-up should be deposited into a savings account where withdrawals are restricted. The full borrowed amount is repaid flexibly with no fixed installments, as is the case for some of SafeSave's other products.

By combining, loans and savings on the one hand, and flexibility and commitment features on the other hand, financial products can provide the proper combination of liquidity and "incentive" to save needed by specific categories of poor people. SafeSave's P9 product, for instance, is designed to address the need of the poor who want to borrow and save simultaneously. The product features are unusual and might appear awkward. Nevertheless, the strength of P9 lies on the fact that it seems to respond to the need of a particular segment of the poor. Namely, P9 matches well the need of poor people who want to gain a better control over their budget. While financial products such as SafeSave's P9 seem promising, there are no rigorous empirical findings showing their success. Impact studies in that direction could be helpful.

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