TRANSCRIPT OF DEVELOPMENT DRUMS
EPISODE 18 – PORTFOLIOS OF THE POOR

Host: Owen Barder. Guests: Daryl Colliins, Jonathan Morduch

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Owen Barder
Thanks for downloading Development Drums Number 18. I am Owen Barder. What would it be like to live on $2 a day? How do people manage their finances? That's the focus of today's Development Drums. My guests today are co-authors of an important new book, *Portfolios of the Poor*, which helps us to understand how the poor manage their finances. Daryl Colliins is a former professor at the University of Cape Town in South Africa and she is now Senior Associate at Bankable Frontier Associates in Boston.

Daryl, welcome to Development Drums.

Daryl Colliins
Thanks very much Owen. Great to be here.

Owen Barder
And Jonathan Morduch is Professor of Public Policy and Economics at New York University, and is a co-author of The Economics of Microfinance. He is also the Managing Director of the Financial Access Initiative, which is a consortium of development economists that aims to expand access to financial services for low income individuals in developing countries through research. Jonathan has also been Chair of the United Nations Committee on Poverty Statistics.

Jonathan, thanks for coming on Development Drums.

Jonathan Morduch
Thanks. It's great to be here today.

Owen Barder
In *Portfolios of the Poor*, together with your co-authors Stuart Rutherford and Orland Ruthven, you look at how – what is it – 2.5 billion peoples, so about 40% of the human race manage to live on $2 a day. And as we are going to see, some of the answers are quite surprising. You spent, what, several years collecting and studying financial diaries from households in Bangladesh, India and South Africa, which looked primarily not at how families lived but how they use their money, how they earned money, how they spent money, how – what they borrowed, what they saved, what they invested. So before we get into the details of what you found, tell us about your approach. Why did you decide to gather this kind of evidence? How did you choose the families?

Daryl Colliins
Well, I mean first of all the approach was really the brainchild of David Hulme at the University of Manchester. Him – he and Stuart Rutherford decided that what was really needed in order to really understand how the poor manage their money was not a one-off survey, and neither was it necessarily an ethnography, you know, a situation where you would go and you'd study just a handful of families in excruciating detail and essentially live with them for a long period of time. And they rather came up with this concept of the financial diaries which are fortnightly visits to a relatively small number of households now in Bangladesh, that was 42 households, in India it was 48, and in South Africa it was about 152. And what we did was we saw these households every other week for about one year. And the word diaries is a bit of a misnomer. The households did not actually keep their own diaries. We had field staff that went

and visited them and took down all their financial flows, what came into the household in terms of income or remittances or sales of assets, what went out in terms of expenditure and input into different financial instruments, the loans…

Owen Barder
So in effect you wrote a diary for them?

Daryl Colliins
Essentially yes, that's right. Yes.

Owen Barder
Oh, they must have got to know the families quite well?

Daryl Colliins
Very well. And that's – that's actually really the point is that what we found is that barriers would break down as we got to know the households better. And you really can't underestimate. I mean these were, you know, in total a series of, you know, anywhere between 25 and 30 meetings that we had with these households. And we really got to know them very, very well. And we found that after a period of time surprising information came out. We – sometimes there were situations where we'd be interviewing a man – husband and wife, and each other would tell us things that the other one didn't know. So we might – we might actually be in on somebody's secrets they weren't sharing with their spouse or secrets between different generations about how they handle their money.

Owen Barder
So with about 300 households in total, or a bit less than that, you're not saying that this is necessarily a representative sample. And it wasn't chosen at random or anything like that. So these are not – these are not randomized samples. So this is a snapshot of these particular families. But are you – do you think that you can draw broader conclusions from the sample?

Daryl Colliins
Yes, in many ways we can. I mean let me tell you a little bit about the sampling. We are not at all saying that this is representative – I mean with such low number you wouldn't want to – want to say that in any way at all, but – and also this sample was drawn in a very stratified way. So what we did is we chose certain poor areas, usually it would be – and each area there was an urban area and a rural area. And we – within those areas we would do participatory wealth rankings, and that would help us figure out who is the wealthier in each neighborhood and who is the poor. So, participatory wealth ranking is when you get people from the actual neighborhood and they rank each other in terms of wealth.

Owen Barder
Right.

Daryl Colliins
And then we draw on the consistent ones. So we were hoping to get not only a rural/urban flavor in our sample but we also wanted to get the very poorest, the sort of medium poor and then we did want to also track some of the wealthier households in the poor areas.

Owen Barder
Right.

Daryl Colliins
Because they are often a lynchpin to the whole financial system.

Owen Barder
Right.

Daryl Colliins
And so one of the reasons why we wanted to bring all of these studies together in one book is because it does show that even across such diverse environments, you know, from the townships of South Africa to the villages of India there are a lot of consistencies…

Owen Barder
Right.

Daryl Colliins
…in terms of how people manage their money.

Owen Barder
And this is rather important, isn't it? And what *Portfolios of the Poor* does is it gives us an insight into a group of people which we haven't known much about, but who constitutes as I said earlier, about 40% of the human race. So this is – this is a very large number of people for us not to know very much about how in detail they manage their money.

Jonathan Morduch
Yeah, I think that's really the big point is that we've got all these big surveys that are done by the World Bank, United Nations and government statistical agencies that cover thousands and thousands of households, which is still a very small chunk of the billions. But they don't give much information in detail. And so the – what the financial diaries do is just step back and say let's get to know some particular households that are representative in important ways and really understand what their negotiations are, what their strategies, what their trade-offs are, what their struggles are, to be a bit more systematic than an ethnography. And the sample is much too small if we are really testing theories. But it seemed rich enough and big enough to do something which is I think at this stage more important, which is really generating theories, going back to our assumptions and really trying to re-imagine and sort of get a hold on the real problems of poor households as they live them day to day and week to week.

Owen Barder
We will come on in just a second to what we did learn but as we do that, could you paint for listeners a picture of some of the kinds of lives that we are talking about, what kind of people are they, what kinds of incomes are they earning, how are they spending money, just so we have a shared picture in our head of what kinds of households and what kinds of families you were talking to?

Daryl Colliins
Well, let me tell you a little bit about for example one of our households in the urban areas of South Africa, a woman named Pumza who was a sheep intestine seller. She lived in one of the hostels, a very, very crowded area and she supported four children. She received one government grant to support one of the children. That was about $15 or so every month. And then she otherwise supported the family on the sheep intestine business. So this was a very daily and very – lot of fluctuations in the income. Sometimes she wouldn't know if she would be making sales or not and sometimes she had to patch her – that cash flow by borrowing so that she could buy new stock and then therefore sell the next day.

So that would be a good flavor of someone in the sample who really had a very irregular income which was a key focus of what we found. We found that households not only had quite low incomes but they also had very, very irregular incomes.

Owen Barder
Right, it's very easy to get sucked into the idea that there are people on the dollar a day so they're getting a dollar each day because of course lots of households are getting more money after the harvest or during – when there's labor income during the harvest season or they have got – they are working as irregular laborers and so they get work when there is work and no income when there is no work.

Daryl Colliins
Yeah, that's right, that's right, exactly. And I mean a lot of these – a lot of households are doing many different types of livelihood income generating things. They are selling on the side at the same time that they might have a casual job, at the same time that they are selling – that they are growing things to sell. Or they might also be getting remittances from relatives on a regular basis or an irregular basis. The point is that you really don't know exactly how much money you are going to have over the next period of time. So that makes it even more important to manage what money you do have very, very well and try to smooth those lumps that that income comes in.

Owen Barder
Right, so you've got the problem both of uncertainty about future income and of irregularity. I mean if it's coming in waves.

Daryl Colliins
Exactly, exactly and then equally you have a lot of uncertainty on the expenditure side. You really don't know when your child is going to get sick and you are going to have to see a doctor and what that doctor is going to say and how much – how expensive that's going to be and how many repeat visits. You don't know if suddenly there is going to be a funeral that you are going to have to pay for. You don't know if there's going to suddenly be a fire in your slum and you are going to have to suddenly leave with all the belongings that you can carry but then try to find some way to rebuild your shack and try to find some income to find the materials to do that. So not only is there uncertainly on the income side, there is also uncertainty on the expenditure side.

Jonathan Morduch
One that's a – it's just one of the – you made a really important distinction for economists, the distinction between irregularity, that's something that's predictable but has ups and downs versus uncertainly where you really don't know what's going to happen. And one of the things that we see is that when you lack financial tools that the distinction really is very blurred even if something's predictable. If you don't have the tools to deal with that, then it pretty much often feels like it's…

Owen Barder
Right.

Jonathan Morduch
…like it's something very uncertain.

Owen Barder
Knowing that you are going to get money in the future is less important if you can't borrow against it.

Jonathan Morduch
Yeah, exactly.

Daryl Colliins
Exactly, exactly.

Owen Barder

And this comes to the question of – I mean I guess that I found the book challenging at first because I started with the assumption that for financial services to be important and relevant you need to have money and the very poorest people would not be people who would make a lot of use of financial services. And of course, the book demonstrates and your research demonstrates that that's just fundamentally wrong that the very poor do not live hand-to-mouth in the way that you might think, that you might think that people who are very poor and living on the subsistence line just consuming every penny they get as they get it. In fact, what you are showing is that they don't do that at all, and that they are making enormous use of different kinds of financial services both formal and informal to smooth both their income and expenditure.

Daryl Colliins

Yes, I think that if you ask any of the respondents, lot of times they would say, well, I don't have any money, so therefore I closed my bank account, or I wouldn't have a bank account. Yet at the same time they would have a savings club or they would be trying to save money under the bed or they use a money guard. And I think that part of this comes from sort of a perception of what living hand-to-mouth is, and a perception of what financial services are. I mean at the end of the day, finance is a relationship between time and money. And if you're somehow trying to hold back money or push it forward across time, then that is some sort of financial interaction.

So part of what we did was we tried to become very, very broad in terms of what we considered financial instruments. Not just including the formal things, like bank accounts and formal loans and insurance policies; but also informal devices, like savings clubs and burial societies and saving money under the mattress. But also stretching even a little bit further, and saying okay, well some people purposely go into arrears on their rent, for example. Or they might get a wage advance. Or they may run a small business and have one employee and purposely sort of avoid paying that employee their salary, because they don't quite have the cash flow that day. We still consider some of those things financial devices, because it was a choice of moving money across time.

Owen Barder

Let's pause on the reasons why the poor need access to those kinds of services, which as you say are not just the – going to the bank or going to the Grameen Bank for microfinance. And you talked about three in particular: the cash flow management issue that we talked about, we need to smooth cash flow; coping with risks as the second; and the need from time to time to raise big lump sums if you're paying in India for a wedding or in South Africa for a funeral, for example. Do you want to say some more about the kinds of reasons why the poorest people need access to these kinds of services?

Jonathan Morduch

I think the poor households we came to know have much, much more risk –live in much more risky environments. And we saw in India for example and Orland Ruthven has worked out that about half of the households had major illnesses and health problems over the year, and about the same in Bangladesh. And dealing with that – these are problems that come up immediately – is very much a financial problem, not just a health problem.

So Orland Ruthven talks about – so when she got to know by the name of Faisal, who had a business as a seller of aluminum pots, he was a pot salesman, and he broke his leg, and he put off treatment for about six months, I mean a serious treatment for about six months, because he didn't have the finances together. And he lost a lot of money in the process and it took him a long time – longer to get better.

And so we really see the – sort of the risk side, especially the health issues, some of the property and fire damage issues as well. Living in a slum is a very uncertain environment. It became central for so many of these households.

Owen Barder
Right, so the poor need some way of coping with both positive and well – particularly negative shocks, like having a health problem or being robbed or losing assets in some way.

Daryl Collins
Right, exactly. Especially the unexpected ones that come up suddenly that you can't really plan for.

Jonathan Morduch
I spent a lot of time working on microfinance, which is the idea of making small loans to poor households to help them build businesses. But we saw that like in much of the world, it's very hard to run a business if there's health problems going on and other fundamental uncertainties. And we saw that in many ways, creating that foundation of greater reliability, greater certainty, is – I wouldn't go so far as to say it's a precursor of something necessary. But it's very hard to raise income, earn income without dealing with more fundamental issues first.

Owen Barder
Right. But I think again, what's striking about this section of the book and this part of your conclusions is that if you have lower incomes, you actually need more financial management, more financial services than if you have higher incomes. The fact that you have a big health cost, if you have high income and you're relatively wealthy, you can deal with it out of pocket, if you're poor, you need some way of raising that money immediately.

Jonathan Morduch
Right. The other thing is that the downside, when you're living on such a thin margin, the downside risks are huge relative to the downside risk for most of us. And that really pushes people to focus on their finances, to be much, much more active about it and come about it with much greater urgency. So when the households talk about all of their financial dealings, they're very active and quite complicated. And many of the households are – at least in Bangladesh and India are functionally illiterate and so they keep track of all of this in their heads. And you say, well how do you keep track of the 15 things you're doing it at any one moment? And they say, well, this is really important. This is what keeps us up at night.

Owen Barder
Right. Let's come to this complexity, because this again is something that I found surprising. I think in the South Africa studies, you found that on average, households use 17 different financial instruments over the course of a single year, and that an average household – I mean these are the poorest households you're studying – would have, at any given time, a portfolio of four savings instruments, two insurance instruments and 11 credit instruments. And as you said just now, Jonathan, all being kept track of possibly in people's heads about what's going on. What's your explanation for why people are using so many different instruments all at one time?

Daryl Collins
Well, I think if you look at sort of what that portfolio represents – one of the ways that – I used to be a portfolio manager, you mentioned my background at Lehman Brothers and I went to South Africa to be a portfolio manager. And the portfolios of the poor work in a very similar way to the portfolios of the rich. You tend to have a purpose behind each of the instruments that you have in the portfolio and you might assume that like, well my goodness, if there are so many credit instruments, then maybe what is going on is that they couldn't get enough credit in one place.

But we found that type of explanation is not necessarily correct. You have different credit happening for different purposes. So what you might have is a couple of one-on-one borrowings in one-on-one loans. And those are very, very short-term, small transactions with your neighbor or your relative or what have you, and those are just patch cash flow, really. And then you might borrow from the local store, or take credit from the local store. So in other words, take on credit through the month and then whenever your income comes in and whenever you can, you pay off that credit bill.

And in addition, you might have a slightly larger loan to do something bigger that you're trying to accomplish. That might be a business loan, it might be a loan for – a number of households in South Africa have a loan for when they get married and the expense of the dowry. And at the same time, you also can have a number of different insurance policies.

So the big insurance policy that people hold in South Africa is funeral insurance. Burials are very expensive in South Africa, often times they cost up to about seven months of income. And it's very difficult to pay for those all at once. Almost impossible to save up for them. And of course, you never know when they're going to hit. So you tend to like to try to insure against them now.

Now you can either have informal burial societies, you can also have formal funeral policies that are offered by the major banks and insurance companies. But most households have a mix of both, and each one has a particular purpose. So for example this – somebody might have a burial society that pays for the cow that needs to be bought for the funeral, and they may have a funeral insurance with one of the banks, and that's going to be what pays for the casket. And another burial society may pay for the remainder of the food.

So there tends to be this very close relationship between the purpose and the use of that instrument and in the instrument itself.

Owen Barder
And was this finding broadly replicated in Bangladesh and India as well, that households had a complex portfolio of different instruments at any one time, with these instruments matched to the particular purposes for which they were intended for?

Jonathan Morduch
Yes, what Orland Ruthven and Stuart Rutherford found was something quite similar. Products tended to match purposes, and there were a broad array of products partly because of a lack of reliability of any particular product, also a lack of liquidity in products. And so Orland Ruthven for example found that on average, households that she got to know were opening – starting a new product every two weeks. So very active engagements, starting a new relationship and shutting something down. So every two weeks, some new engagement on average. Stuart Rutherford was finding that about a third of the households he got to know were using over 10 instruments at any – across the year.

Owen Barder
Right.

Jonathan Morduch
And so, this is a sample that's considerably poorer than the sample that Daryl got to know, and they're still very financially engaged.

Owen Barder
We should just remind people, Stuart Rutherford was looking at Bangladesh, Orlando Ruthven at India, and Daryl was looking in South Africa.

Daryl Collins
And the portfolios really do have a lot of similarities in terms of their texture. The purpose – I mean for example, in India and Bangladesh, rather than funeral plans on the insurance side, you would find savings instruments that would help people save for weddings. Because weddings were sort of the big life cycle important event that people save for in that culture.

So you would see slightly different instruments. But the overall context, in other words, the fact that people were managing these big complex portfolios and they covered savings and credit in some sort of insurance and short-term loans and long-term loans and savings for different purposes. They were very compartmentalized.

And I think that ties back to our point about, you know, when you're poor, it's so much harder to manage your money, because you are operating on a thin margin. And the way you help yourself to set money aside is to remember why you're doing it. And I think that that's one of reasons why you have the instruments tie so closely into the purpose.

Jonathan Morduch
Yes, I was just going to say, of course this understanding is now a big part of the new field of behavioral economics, which is sweeping European and American academic economics. So in the jargon of behavioral economics, this is called mental accounting. But it's just a very simple sort of day to day measure that the households that we got to know were incorporating into their lives.

Owen Barder
Do you want to say something about the use of money guards? Because I suspect there will be people listening – you mentioned them earlier – who don't know exactly what they are. And they're an example, aren't they, of this kind of behavioral economics view of the way that people set aside money.

Jonathan Morduch
Yeah, money guards are really very simple and very common devices. And basically, money guards are all about asking a friend, a trusted friend to hold some money for you. And the key feature in terms of managing your money – after all, this is something you could do on your own, just put money under the mattress, the key feature is it provides a commitment. It takes the money out of the households where it's tempting to spend and puts it in somebody else's hands.

And so we found situations where somebody would ask their neighbor to hold a few dollars for them. The neighbor in turn would ask the household to save a few dollars for them. And so they'd each be holding each other's money and yet – you know, they understood what this was all about. And it did provide a useful commitment to not spend that money, just somehow put it aside and keep it out of temptation's way.

Owen Barder
But in those examples, those kind of informal examples, there's no cost. And, of course, we're used in rich countries to, for example, having a direct debit or a stop order that puts money into a savings account. But we get paid to save money through the interest rate.

But in – there are – quite a lot of examples aren't there in developing countries where there is actually a cost to people to using money guards. They pay in each day of the month for example but they get – they only get 29 out of 30 days back again at the end of the month.

So people are actually – there's a big negative interest rate. People are actually paying somebody to fulfill that function for them, which might be a bit counter-intuitive. You're actually somebody to deal with the fact that you don't trust yourself or you don't trust your husband or your family.

Daryl Colliins
Yeah. So it's an example that Stuart refers to frequently of the deposit collector in Bangladesh who goes around and collects money for a fee. And I think that the point here is that it's so difficult often times to get money out of the house and to not spend it that you're willing to pay someone to do that. And it does turn all of our ideas about how people manage money and that the interest rate is really central. It really

turns out around. And in the portfolios of the poor, the interest rate is not – it's not off the page by any means. But it might not be as central as economic theory puts it.

Jonathan Morduch
Yeah, the deposit collector does something really very helpful for households. A deposit collector will come around to the households and take a fix amount of money maybe every day or every week and at the end of a given period will repay the money less a fee and then the household has a big sum.

And really that feature of taking small amounts of money and converting them into something usefully large is a big feature of most or many of the informal financial services that poor households are creating with their neighbors whether it's a savings club or something else. It's all about taking small amounts, creating some structure to make it regular and create discipline and in the end having a big chunk that you can do something with.

For us, we take it for granted that you can convert little bits of money into something big. For poor households, it's extremely hard and worth paying for if you can do it right.

Owen Barder
And it's well worth noting that even in industrialized countries there are schemes – I mean Christmas clubs here in the UK or saving stamps. There are lots of examples of people doing that still in much wealthier societies. This isn't – it may not be what university professors and development economists do but there are lots of people in industrialized countries engaged in quite similar transactions aren't there?

Jonathan Morduch
Yeah. Exactly, I mean Daryl got to know a woman named Numsa who with her friends essentially created a Christmas club. Daryl can say a little bit more about the structure of that. But it will seem very familiar to people who are used to those industrial country solutions.

Daryl Colliins
Yeah, it was amazing how effective this clubs can be in terms of being able to sort of suck out the sort of excess monthly income that people have in their monthly cash flows. You would think that there wouldn't any excess at all but because you have this payment that your friends are depending on, you can put aside quite sizable amounts of money.

So Numsa and her friends would put aside relatively small amounts of money, say about $9 or so a month and then this would all add up. Actually it was under somebody's mattress. This is in the rural areas of South Africa. All the money added up under the mattress. And then they would split it in December just in time for Christmas, which is a rather big holiday in South Africa.

And it's amazing because Numsa – if you look at who she is, she is not one of the wealthier people in this rural sample. She was actually quite poor. She supported herself on a government old age grant of about $115 a month. And she supported herself and four children. And when we actually looked at how much she could set aside using these savings clubs – she used two of them. And in total, she set aside about 25% of her income, which was not terribly unusual within the South African sample that we followed.

So it's amazing how these savings clubs and the structure that they provide and the commitment device that they provide can really help people save quite a bit out of their incomes.

Owen Barder
Did you find big differences in behavior in use of these kinds of systems between urban areas and rural areas in the three countries you looked at?

Daryl Colliins
I think that what we found in South Africa is that there were more – there was more use of burial societies in rural areas than in urban areas. But a lot of that goes back to the fact that a lot of people in the urban areas will go back and be buried in the rural areas. So a lot of the expenses are sort of held there.

So I think that people try to protect themselves a little bit more. Otherwise you may find that people in the urban areas actually send money home. And in some ways that can be a means of saving. Either the money gets sent back home and invested into a physical structure like a house.

Owen Barder
Right.

Daryl Colliins
Lot of the respondents were building homes in the rural areas. And that was in some ways their way of investing into the future that they had actually put their savings into brick and mortar. So there was that type of cash flow. Some times that money got sent back to the rural areas as expenditure to support family members who lived in the rural areas.

I was very surprised in South Africa that people living in rural areas were just as busy in their financial lives as those in the urban areas. You would think it would be the opposite. But there is just as many transactions and savings clubs and all sorts of devices happening between people living in the village as there is – with people living in a township.

Owen Barder
Okay, so that's important that you're finding that in rural areas too that people are – to what extent are these formal financial institutions and to what – I think I remember from the book that about 70% on average of these kinds of financial activities were informal broadly defined and about 30% formal. Is that – was that true across the samples between the countries and across urban and rural areas?

Daryl Colliins
That would be a bit more the case in – I mean the South African sample had a bit more formal engagement than Bangladesh and India. Really what it seems to be tied to more than anything is whether you have formal employment or not. So in South Africa if you were, say, a teacher in a rural area, you would not only be very, very likely to have a bank account, but you are also probably likely to have some sort of provident fund, some sort of life insurance.

And plus teachers in the rural areas are very targeted by insurance companies. So you probably have all sorts of retirement annuities that you have no idea what they are. But you have them. And so automatically, having a job and a regular job increases your likelihood of interacting with the formal sector. In Bangladesh and India, there was a lot less formal job and salaried job engagement. And so you saw a bit less formal instruments in their portfolios.

Jonathan Morduch
Yeah, in India and Bangladesh what you do see more of is microfinance, especially in rural areas. So that was a little bit of a difference. But overall, the differences between rural and urban were not so great as the commonalities.

I think there was one thing that really struck me and was surprising by this, is as an economist, I think for decades we have had this idea that the formal sector will come forth and develop and will squeeze out the informal. But we didn't really find that.

We found in fact that all these informal things were happening alongside the formal. And the formal comes in just as another instrument in a broad portfolio.

And so it really helped us rethink sort of what we are doing when we're creating microfinance. It's not kind of the new thing that you gravitate toward. It's just another option that you maintain alongside your money guard and your deposit collector and all those other options.

Owen Barder
Let's talk briefly about the price of financial services. Daryl mentioned earlier that one of the conclusions is that price matters, the interest rates that are being charged are not completely off the page. But they are quite a lot higher.

But the judgments that people make about their choice of instruments and so on don't seem to be as dependent on price as on other things such as reliability and transparency and relevance to the particular purpose that they want to use the instrument for.

Is that a correct conclusion that price – that these choices are not very price dependent, not very dependent on interest rates.

Daryl Colliins
Well, I think it's something that you have to really look at very carefully. I mean what I found is as a portfolio manager you would look at the return on an investment. And that would be key. You'd look at the cost of borrowing money and the return on your investment. And both of those figures would be in percentages.

In many ways, when you think about the portfolios of the poor, you really need to think of the levels, like the fees and so rather than thinking of the cost of a loan in terms of an interest rate, think of it rather in terms of the fee because many of these – many of the loans that households would take especially in the South African sample and most of – a lot of the analysis that we did on price was done on moneylender loans in South Africa.

A lot of these loans would be very, very short term. They would be less than a month. Yet the price on them was quoted at 30% per month, which sounds astronomical when you take that in to an APR. But if you think about it, they are only – if you are only borrowing, say, $20 then 30% of $20 that you are going to pay back in 10 days' time isn't really that much within the whole portfolio cash flows that you are going to be carrying them on.

So if you think of it rather as a fee than as an interest rate, it slowly starts to make a bit more sense. Also if you think of what that cash flow bridging loan might be, I mean you are only going to be taking that loan for 10 days what you are really trying to do is tied you over until some other money comes in. Well you are not going to want to sort of keep it around and need to pay interest on it over months and months and take your time in paying them back. You won't pay it back very quickly, because what if a situation like that happens again and you need to go back and borrow money for a second time. You want to sort of clear up that debt so that you are free to be able to borrow again.

So it's really important to look at a lot of the different elements the context in which you are borrowing, for how long you are borrowing and the size of the loan. We are not talking about a big capital loan here that people would take six months or a year to pay back, we are talking about this 30% per month often times we are talking about a very short-term loan relatively small sizes and a cash flow type bridging loan. So we had to be very careful in our own minds that we are comparing apples-to-apples that, that 30% per month is not compared to our mortgage rates.

Owen Barder
Right.

Daryl Colliins
In our own minds.

Owen Barder
So that's a way of explaining why it is that what look to us like astronomical interest rates or perhaps not so challenging if people borrowing the money and this is small amount of money and for a small period of time. But is it right nonetheless that price is not the main determinant of people's choices.

Daryl Colliins
I think there's also – I mean what we found is that convenience.

Owen Barder
Right.

Daryl Colliins
And reliability matters a great deal as well. So knowing that you can walk across the street and borrow from the moneylender and you've got a very, very high probability that is going to give you that money that you need right then and there because somebody is waiting to take that money to go and help pay for a funeral that you said that you're going to contribute to. That matters a great deal.

Owen Barder
Right

Daryl Colliins
And that matters certainly equally as much as price if not more.

Owen Barder
Right, okay that makes sense. So we've established that or you've established that people who are living on $2 a day, are much more prolific users of financial services than you might imagine that that seems to be true across a number of countries, it seems to be true in rural areas and urban areas. Let's look at what that means for people who are interested in the delivery of financial services whether that's private sector firms, you might be interested in scaling up the delivery of financial services or policymakers and so on.

I mean what I wasn't clear on from reading the book is whether you think there's unmet demand. Do we – does your approach enable us to say that there are particular types of services that people don't currently have access to but would like to have. We know that they make a lot of use of the services they do have but that doesn't let us necessarily mean that there is room for more services to be available to them.

Jonathan Morduch
Yeah that's a – it's a great question and sometimes we don't know what people really want until a new product comes along and then we see whether that thing is popular or not. One of the things we see is, there's a lot savings and this is surprising to lots of people that poor households can save so much they can save – do save, they want to save. But a lot of it is short-term, it's may be to bridge something that's going to come up in four months or within a year. Very little – the very few ways to save longer-term except perhaps through investing in your house.

And one of the things we saw in Bangladesh over the last few years is the introduction by Grameen Bank of a new long-term saving product. It's either a five year or ten year term. It's been extremely popular.

Most of the households we got to know have no access to anything like that and it just sort of underscores a big gap in financial needs.

But I think the second thing is that while there are lots of devices that people have, they aren't always reliable and you don't always know it that you are going to be able to get the money when you need it, in the amounts you need it. And so Daryl has got lots of stories about savings clubs falling apart, about theft, robbery. But the bigger issues are that we do see people having to skip meals at least one meal a day when they can't get their finances together and also some really tragic stories about people really suffering in terms of their health when they can't get loans to buy medicines or go to a doctor. Sometimes leading to death actually and so – well there's a lot of activity, we do see lots of gaps as well.

Owen Barder
The people who are having to skip a meal or unable to get healthcare that they needed at the time they needed, you are implicitly attributing that to a failure of the provision of financial services rather than the fact that these people are just too poor.

Jonathan Morduch
What's interesting – and it's a great question and this is one of the big questions for donors in the private sector. When we look at these cases of the health problems, they look like problems that are being fixed elsewhere by simple insurance mechanisms. So that definitely does seem like a gap in terms of financial services. The others where people are skipping meals these are during low seasons, where they're actually doing quite well in the higher seasons. And so again, goes back to something you said in the beginning if people earned a $1 day or $2 a day, every day their lives would look very different. And these gaps are happening because they don't and income is irregular and needs are irregular.

So it wasn't so much poverty itself as these ups and downs that households are having difficulty dealing with.

Daryl Colliins
Either you can exactly – you can see exactly in these portfolios where the – where the problems are – because we not only tracked what – how people manage their money, and what types of financial instruments they had and the ebbs and flows in their portfolios. We also tracked what happened to them in terms of unexpected events and expected events. So we could see the risk that they were facing, at the same time that we saw how they used their portfolio to try to manage those risks.

And when unexpected things happened, there isn't a lot untied savings. So we described these savings clubs that are incredible generators of savings towards a particular event or particular time. But when something unexpected happens often times there is nothing in that portfolio that would allow a household to meet that financial demand except for a very high price loan that they might not be able to service or to sell an asset that they really needed. You can directly see how the portfolio is failing in those unexpected ways.

So I think often times you may have an impression when you hear how wonderfully or how innovative poor people are about managing their money that, well gosh, well perhaps this is all that they need and who are we to interfere and perhaps this is all working great. But you can see very clearly that there are gaps that need to be filled in some other ways that informal services have not sort of necessarily innovated to come up with some sort of solution.

And that – that is the place that formal services need to target.

Owen Barder
Have you identified the reasons why, I mean, if there are these needs that for the services that people do use in formal arrangements have proven very effective, they are widely used, that's covering 70% or

thereabouts of lots of people's current use of financial services. There must presumably be reasons why informal arrangements haven't evolved to cover the kinds of services that you're talking about which are still absent either in terms of the coverage, this for example long-term savings instruments or the characteristics that you think you – that they need to have.

Jonathan, you talked earlier about the need for more reliable, more transparent services. Why haven't the informal arrangements evolved over the years to fill that – those needs and why would formal arrangements work given formal arrangements haven't filled those gaps?

Jonathan Morduch
Yeah, it's an important question. I think we look at both of those examples that you raise the long-term savings and thinking about, say, risk and insurance. Those are both areas that involve a lot of trusts. I mean both of those institutions in Europe or the United States elsewhere. Those are institutes – those are contracts and products that depend on your believing in the viability and trustworthiness of the financial situation you are engaging with and that's exactly where the informal sector breaks down most often. You can maintain trust and reliability for a stretch but when you are thinking about five years out to ten years out or if you are thinking about needs like a health problem or a crop loss which are acute and where you are really going to have to rely on people to a great extent. Really the informal sector has a very much harder time delivering and that's exactly what the formal sector is all about, what financial intermediations extremely good at doing, hedging risk and creating long term services.

Owen Barder
There is a lot of wind in the sails of microfinance movement at the moment. It's a pet subject for lots of – particularly of private givers who are attracted by the idea that enabling people to borrow money so they can set up a small business and earn an income themselves is a better way of helping people, better way of supporting people because you'll – you have the sense that is temporary that you are giving people a hand up and that will put them on their own two feet. But what I found interesting in your discussion about the way that the poor use financial services is the very little of it, it is about using financial services in the form of microcredit to support businesses. It's much more about smoothing incomes, smoothing consumption, managing insurance, managing risk. There seems to be a kind of discontinuity between the rhetoric around microfinance and actually the way that the poor are actually using financial services and the kinds of financial services that they continue to need.

Jonathan Morduch
Yeah, I think that here – the book really lays out a vision or begins to lay out a vision that could help take microfinance forward to another level. We're really thinking about broad financial provision. I think microcredit for small business, right, the original vision that you described is a very powerful vision and we do see especially in India and Bangladesh many households taking advantage of microcredit to fund their businesses, but it's not the one thing they want, it's not necessary and not the most important thing they want.

And one of the things that's striking when we have a chapter where Stuart Rutherford goes back to Bangladesh and does an additional set of financial diaries on a group of households that are Grameen Bank customers. Grameen Bank of course is the great pioneering microcredit institution; the Nobel Prize winner. And he finds that less than half of the households are borrowing mainly for running small businesses. Instead they're paying for health needs and they're making sure their kids are in school and they are dealing with consumption needs and they have – and the businesses is there, but it's not necessarily the big thing that they are borrowing for.

And that makes a lot of sense in terms of the broader picture that we're seeing. Households are running complicated lives and they are doing it in complicated environments. And so what we're trying to argue is that for microcredit to move forward, as opening up to thinking about loans for a broad range of purposes are going to not only fit better with what households want to do, but fit better with what households are already doing with the loans they are taking.

Owen Barder
Right, I mean I have absolutely no problem at all in making the case that giving people access to financial services, to enable them to eat more than one meal a day or not having to skip healthcare that they need is an important function but it is – it will rub up against a lot of this kind of ideology won't it? That – because that's going to be a continuing need, that that kind of transfer; it doesn't seem likely to catalyze and spark the economic growth and jobs and prosperity that microfinance has been promising hitherto and for which the evidence is grievously lacking.

Jonathan Morduch
Yeah, now that's absolutely right. It's really calling for a change in rhetoric and really calling for a focusing on what households are doing rather than the kind of messages that sell well in New York or London or Paris. And we're arguing that if you spend time with households in Bangladesh or India or South Africa or places like that, you really start to see a very different story that can lead to a different kind of rhetoric. But just to clarify, the microfinance vision has not been one where it's been one where donors get in and give money and get out, but from the customer's perspective, from the household's perspective, the idea always has been that you would have a sustainable financial institution that would be with them over the generations and so the idea was never that the microcredit organization would only be there for a temporary time.

And so in that sense, the kind of continuities that would be necessary as one expands lending for consumption needs etcetera is actually quite similar to what we're seeing today. It's just opening up and recognizing that people are doing more complicated things with the money that they have.

Daryl Colliins
I mean – and just to enhance upon that, I did a bit of financial diaries on small businesses in South Africa earlier this year using the financial diaries again and when you find that when you really go into how small businesses are run, we have again this idea that they need these big capital loans to expand their business and because they are going to expand their business then they are going to make more money, they are going to hire more people and then you know you start to see implications for economic growth and what we fail to sometimes recognize is that oftentimes it's businesses need cash flow loans. They need loans just to manage that still stay in business so that they can keep an income that keeps food on the table and that keeps the school fees paid.

And sometimes sustaining of business is just as important as growing it, and in that way what Jonathan just said about it, having a financial institution that will not only be with you through a period of time, but also will serve you in different ways during different times of that business' growth and life. It's really a much broader way of thinking than those sort of very traditional way of thinking of microfinance where businesses would get a big loan for six months and then pay it back over that time.

Jonathan Morduch
Yeah. There is another, I think point I want to add to what Daryl is saying which is still goes to the other direction, which is that Daryl and Orland Ruthven and Stuart Rutherford got to know lots of households living under $2 a day. Many of them have a business on the side, but some of them don't, you know they don't. They may work for someone, they may be a maid, they may be a rickshaw driver working for somebody. They don't have a small business they don't want a small business, but they do need financial services and they do need small loans and so the vision of small loans for small businesses as sort of exclusive vision of financial access for poor households really doesn't fit with what – billions of very poor households need and are looking for – and I think there is a – I'm not going to say there is a tremendous business opportunity because I'm not a financial advisor in that way.

But there is certainly a big market there that goes well. There you can imagine once you get out of the microcredit box that has served us well for 25 years, and start to think about broader financial services.

Owen Barder
In some ways that message is summed up by your phrase about a triple whammy that the poor face, this triplet of having low incomes, that's by definition that's what makes them poor. They also have unpredictable and volatile incomes. They're not all living on a $1 a day or $2 a day coming in each and everyday, but this is coming in bunches and waves. And they have weak financial institution, so that's – there's the three legs of the triple whammy. And but as a result they need financial institutions formal and informal mechanisms, if anything even more than people who have higher incomes and they'll face that triple whammy. And I thought that was a very powerful in compelling message and for me an unexpected message of this research.

Daryl Colliins
Yes, we really felt that most importantly, the financial services that the poor have, don't necessarily play well to the type of cash flows that they face and the type of risk that they face. And they don't necessarily tie in well to the unexpected events that will come along, they don't necessarily tie in well to the type of aspirations that they have to take advantage of opportunities and to just simply live their lives and fulfill traditions and fulfill family obligations and what have you. So in that sense the financial services that they do have really don't match what they are facing in their everyday lives.

Jonathan Morduch
Yes, I think and another part of it, I mean, is the book very much focuses on finance. And as Daryl has been describing finance is really very powerful way to understand the economic lives and social lives of poor households. And yet, ultimately the book is about re imagining poverty and understanding poverty as it's lived day-to-day and week-to-week in some of the poor parts of the world. And there, the triple whammy is really about saying let's step back from kind of the rhetoric of poverty, the $1 a day or $2 a day measures and unpack that a bit and see both truer descriptions of what it is to be poor and also open up to some new solutions. And some of them, I think some of the more practical ones are in the financial realm.

Owen Barder
I have been talking to Daryl Colliins and Jonathan Morduch, who together with Stuart Rutherford and Orland Ruthven are the authors of *Portfolios of the Poor*. How the world's poor live on $2 a day, which is published by Princeton University Press. Daryl and Jonathan, thank you both very much for coming on Development Drums.

Jonathan Morduch
Thanks.

Daryl Colliins
Thanks very much, Owen.

Owen Barder
And thanks to everyone listening to Development Drums. Thanks for your interest in Development and for downloading the podcast. And you can find links to the book and the website on the developmentdrums.org and you can find this on the Development Drums group on Facebook.

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