MicroSave India Focus Note 84

When You Can't Save Up: Saving Down and Saving Through

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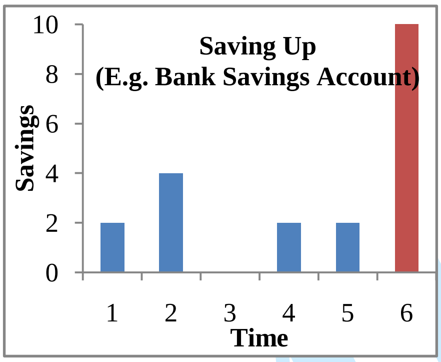
November 2011

We can see access to financial instruments as a way of enabling movement of financial value through time. In other words, savings imply transferring value to the future and loans imply dipping into future cash flows.[1] This Note discusses how low-income households move financial value through time using loans and chit funds in order to access large sums of money.[2] A study conducted by *MicroSave*, which shows that 80% of respondents depend on loans and 60% on chit funds to meet lifecycle needs,[3] emphasises this fact. These two products also force them to save small sums of money, thereby inculcating financial discipline.

Stuart Rutherford argues that people save in three ways: saving up, saving down, and saving through.[4] Saving up implies that individuals save small sums of money over time until it accumulates into an amount large enough to meet a substantial expense. Saving down refers to loans. In this case, households access a lump sum amount to serve an immediate need. Then they deposit smaller amounts over time to repay. Finally, saving through implies that savers access a lump sum amount of savings at some point during a series of savings.



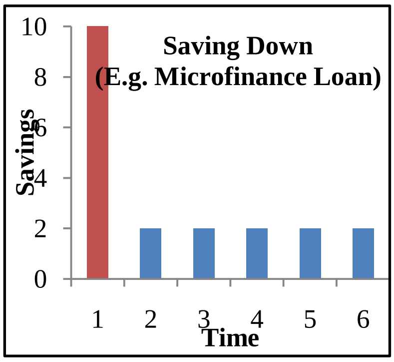
For low-income households, saving up to a usefully large lump sum amount is not easy. The challenges faced by low-income households are three-fold: 1) low incomes; 2) irregular and uncertain cash flows; and 3) lack of existing formal financial instruments that are compatible with their small, irregular, and unpredictable incomes.[5] Thus, low-income households typically rely on saving down or saving through to access usefully large sums of money.

A snapshot of the life cycle events of a poor household shows that in any given year, poor households make large expenditures on marriage functions, school fees, house construction, business expansion, sudden ailments etc, over and above daily living expenses.[6] However, their savings are so low that they are often unable to meet these large expenses. "*Bachat kam hain. Kharcha jyaada hain*" (Our savings are low, but our expenses are many). These large expenditures are often much higher than can be met using savings. "*Jab shaadi byah hua, rin karza kuch karte hain, jab paisa juth pata hain*" (If there is a wedding, the only way to mobilise money is to raise loans). For instance, a buffalo costs about Rs.20,000. Households raise this amount from multiple sources including loans, chit funds, savings etc. School fees, paid at the beginning of the school year usually for two to three children can also be sizeable expenditure for low-income households.

Low-income households manage the shortfall in savings through two major instruments: loans and chit funds.[7] We discuss both these instruments in detail in the sections that follow.

Borrowing to 'Save Down'

Loans represent a way to monetise future savings for low-income households. In the *MicroSave* research sample, the loans discussed are availed either through self-help groups or through microfinance institutions.



Discussions with low-income households shed some light on why they prefer to borrow rather than save. First, it represents an opportunity to access a lump sum amount of money upfront. "*Yahan paisa ikhatha milta hain. To agar, bakri khareedna ho, toh yahan se le lete hain aur kishth bharte hain*" (Here, we get money as a lump sum. So if we want to buy a goat, we take the money from here and repay on a weekly basis). Many low-income households note that the relationship with MFI that they have borrowed from is extremely important to them. "*Yehi aadhar hain, hamare liye*" (This is the basis of our financial lives). Second, since borrowers must repay the money they owe, a loan inculcates financial discipline.

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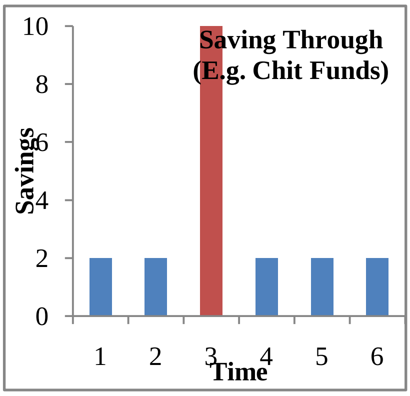
[1] CGAP Focus Note Realizing the Potential of Branchless Banking: Challenges Ahead (Mas, 2008)
[2] The information in this IFN is culled from *MicroSave*'s research on the relative risk of savings of poor households. The research papers on this topic can be accessed here.
[3] *MicroSave* Research Paper (2011) Relative Risk to the Savings of the Poor in Tamil Nadu, *MicroSave*
[4] Rutherford, S. (2002) *The Economics of Poverty: How Poor People Manage Their Money SafeSave*: Dhaka. Graphical representation of saving up, down, and through also taken from this paper.
[5] *MicroSave* PoP Briefing Note 1: The Triple Whammy of Poverty
[6] *MicroSave* Research Paper (2011) Relative Risk to the Savings of the Poor
[7] Chit funds are more commonly known as Rotating Savings and Credit Association (ROSCAs)

Finally, the small weekly loan repayment instalments are in line with their earnings.

With loans, the danger of default due to unforeseen circumstances is clear. With group-based lending, there is an additional risk that one may need to take responsibility for a defaulting member. Furthermore, there is a cost associated with loans, namely interest. However, clients are willing to take on these risks since the benefits appear to outweigh the costs.

'Saving Through' Chit Funds



Chit funds are popular in semi-urban areas in northern India and all over southern India. There are two types of chit funds common in India. In lottery chits, participants draw lots to decide the order in which they collect the accumulated lump sum. In auction chits, participants bid for the amount and the person who bids the lowest amount (i.e. willing to take the biggest discount) collects the amount. This process continues for the duration of the auction chit except the second and last month. In the second month, the organiser gets to take the amount (without a discount), and the person willing to wait the longest gets the full amount in the last month. In both types of chit funds, the participants are allowed to collect the amount only once during the duration of the chit.

Chit funds are useful to raise lump sum amounts of money, particularly for school fees.[8] "*Mottamma vangi, yedaavda pananum naan, idla daan mudiyum. Periya togaiyai kaila varum*" (If we need a lump sum for some purpose, it is possible only through this. Chit funds are good to access a large amount). Thus, respondents are able to convert their small earnings into a larger amount, which they can use for the expenses. Respondents often underscore the importance of this avenue by saying, "*Yengla kaapathrathe indha seet daan*" (This chit fund saves us). Since all members of a chit fund are from the community, there is a strong social contract.

Chit funds have their downsides too. Firstly, respondents complain that one cannot be too careful in choosing the right fund to join. Fund sponsors can swindle members, as can other defaulting members of the chit fund. Secondly, underscoring the importance of access to capital, many respondents say that chit funds are only beneficial if one is able to access the full fund amount early in the cycle. Even though the member who takes the accumulated lump sum gets the full amount at the end, waiting for the money is a negative, since everyone has needs the money for one reason or another.

Saving 'Down' When You Cannot Save 'Up'

Meena, 38, is a resident of Rajgarh locality in urban Alwar, Rajasthan. She runs a small kirana shop and her husband is a tempo driver. They do not have a bank account. Their meagre income is less than sufficient to feed, clothe, and educate her four children. She says loans and chit funds help her access big amounts. Furthermore, she is able to save small amounts every week to repay the loan. Meena prefers the following savings avenues:

- She is part of three groups, two of which are MFI groups and another is an informal chit fund ("*beesi*").
- Beena saves Rs.230 at home every week to repay her MFI loan. She does not like saving money in her house or her shop due to concerns over theft, which she has experienced in the past.
- She saves Rs.3,000 every month with her *beesi*, which runs for about 25 months. She says she will not be able to save up to gain access to lump sum amounts on her own – so the *beesi* group helps her. The *beesi* also serves as safe savings mechanism. She also attaches a high level of trust to the *beesi* because she has been its member for many years and is able to access her money in times of need.

Conclusion

Low-income households often rely on saving down and saving through to move financial value through time. Poor households use informal sector variants of saving down and saving through – at greater risk and cost. This presents an opportunity for financial service providers, as there is a large unmet demand and room for product innovation.

The pattern of usage of these avenues also offers notable insights for developing savings products for poor households. In particular, while current formal products for low-income households offer them the opportunity to 'save up' via basic bank accounts, very few offer them opportunities to save 'down' and 'through' – both more common ways of saving in low-income communities. In recent years, microfinance loans have become a common way for low-income households to 'save down'. Saving 'through' formal products, such as overdrafts is almost completely absent. Evidence suggests that products which allow low-income households to save 'through' and 'down' are more likely to be popular and hence, sustainable.

[8] *MicroSave* Research Paper (2011) Relative Risk to Savings (2011), Tamil Nadu