INVESTIGATING THE
FINANCIAL LIVES
OF THE POOR

FOCUS NOTE: Styles and Profiles
The Connection between Livelihoods and Financial Portfolios of the Poor

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Key Findings:

* Livelihoods do not dictate how many financial instruments households hold, but they influence the type of instruments households use.
* Most of the Financial Diaries households fall into two categories: Regular Wage Earners and Grant Recipients.
* Regular Wage Earners have more sophisticated instruments, like employer-provided pension or provident funds or store credit cards, in their portfolios.
* Grant Recipients tend to have more debt instruments and higher levels of debt service, which indicates that they have more difficulty managing cash flow than others in the sample.
* Business Owners are providers of credit, rather than recipients of credit.
* Households dependent on casual work use the least number of instruments and find it most difficult to build wealth.
* Households earning a formal pension from a previous job are the best off in communities and provide a financial backbone to their extended families.

Each one of us has, among our acquaintances, people with different financial styles – some take huge risks with their money, some just like to spend it, others might be notoriously stingy. Such diversity in financial behaviour is a good thing. In effective financial markets, risk-averse lenders are matched to risk-seeking borrowers, and financial resources are allocated efficiently. Many researchers question whether the financial markets of the poor are effective. This *Focus Note* deals with a different question: How much variation can we find in the financial behaviour of households in the low income sector?

A number of factors could drive different financial styles. Some are difficult to measure: upbringing, experiences and temperamental tolerance of risk. Others are easier to measure: age, wealth, environment and sources of income. This *Focus Note* concentrates on understanding one aspect of financial choice – how people make their living and the income stream their livelihood brings.

Poor households usually derive income from more than one source. In one household, one adult may have a regular wage from a full time job; another may do casual work and have a small business on the side; yet another may get a grant and get remittances from a relative from time to time. So, within one household, there are formal and informal, regular and irregular streams of income. Does the dominance of one of these streams of income make a difference to financial choices and preferences?

Method: Determining financial portfolios by livelihood

We attempt to answer this question by placing the 152 Financial Diaries households[1] into livelihood profiles. We found that six different forms of livelihood produced the main sources of income, as shown in Table 1 below. Households were placed in these categories according to the source of the largest contribution to monthly income. As Table 1 shows, most households fit into two profiles: Regular Wage Earners and Grant Recipients. These two profiles account for 76% of the households in the sample.

Most households are dependent on more than one source of income, so we include a line that reports, on average, how much of the household income comes from the main source. Table 1 also gives some basic information about each profile. We start by showing the percentage of each category living in urban (Langa and Diepsloot) versus rural (Lugangeni) areas. The Regular Wage Earners mostly live in urban areas, while the (small number of) Formal Pension Recipients[2] live entirely in the rural areas. Grant Recipients and those living off Remittances from Relatives are also largely, but not all, rural.

Next, we wanted to get some idea of the financial well-being of the household. The average monthly income is the average income over the period of the Financial Diaries survey and across all households in the profile category. It is important to note that this income includes all sources of income and not just the main source of income. As Table 1 shows, Formal Pension Recipients and Regular Wage Earners have the highest level of monthly earnings. Those who are dependent on income from others, that is, Grant Recipients and those receiving Remittances from Relatives, have the lowest monthly income.

Net worth is calculated by summing the value of all the household's physical and financial assets and subtracting financial liabilities. Households can have high net worth, despite low income. In many cases, this may be because they inherited a home or livestock. The next two ratios capture the net worth of households in different ways. The debt service ratio is a flow variable, calculated as monthly debt payments – which includes actual principal and interest payments on both informal debt payments (such as moneylender loans) and formal debt (such as bank loans) – over gross monthly income. The debt equity ratio is a stock variable which is the ratio of the stock of financial liabilities to the sum of physical and financial assets.

To determine the financial instrument portfolios for each profile, we first counted the instruments used by each household. We then selected instruments that are used by at least 50% of the households in each livelihood category. This determined the list of instruments commonly used by those in the livelihood profile. We then took an average of each instrument used per household.

Table 1: Livelihood Profile Statistics

	Regular Wage Earners	*Grant Recipients*	*Remittances from Relatives*	*Business Owners*	*Casual Workers*	*Formal Pension Recipients*
Share of sample in profile (%)	49%	27%	9%	7%	5%	3%
Share of monthly income earned from this source (%)	81%	77%	72%	70%	61%	72%
Urban[a] share of profile (%)	87%	25%	36%	91%	57%	0%
Rural[b] share of profile (%)	13%	75%	64%	9%	43%	100%
Financial statistics						
Average monthly income (R)	R4 102	R1 213	R1 291	R1 964	R1 316	R4 381
Average monthly income per capita (R)	R1 419	R398	R398	R660	R724	R2 404
Average net worth (R)	R110 801	R54 424	R47 143	R69 334	R19 529	R796 733
Debt service ratio[c] (%)	13%	17%	8%	5%	6%	12%
Debt/equity ratio[d] (%)	22%	23%	25%	16%	13%	23%

Notes: [a] Urban: Langa and Diepsloot. [b] Rural: Lugangeni. [c] Monthly debt payments over gross montly income. [d] Financial liabilities over the sum of physical and financial assets.

[1] The *Financial Diaries* study began with 180 households. Through attrition and missing data, this number has dropped. The 152 households included in this exercise are those that have a complete set of year-long cash flows.

[2] These are retired people who are receiving a pension from a formal job, NOT the recipients of the government old age grant.

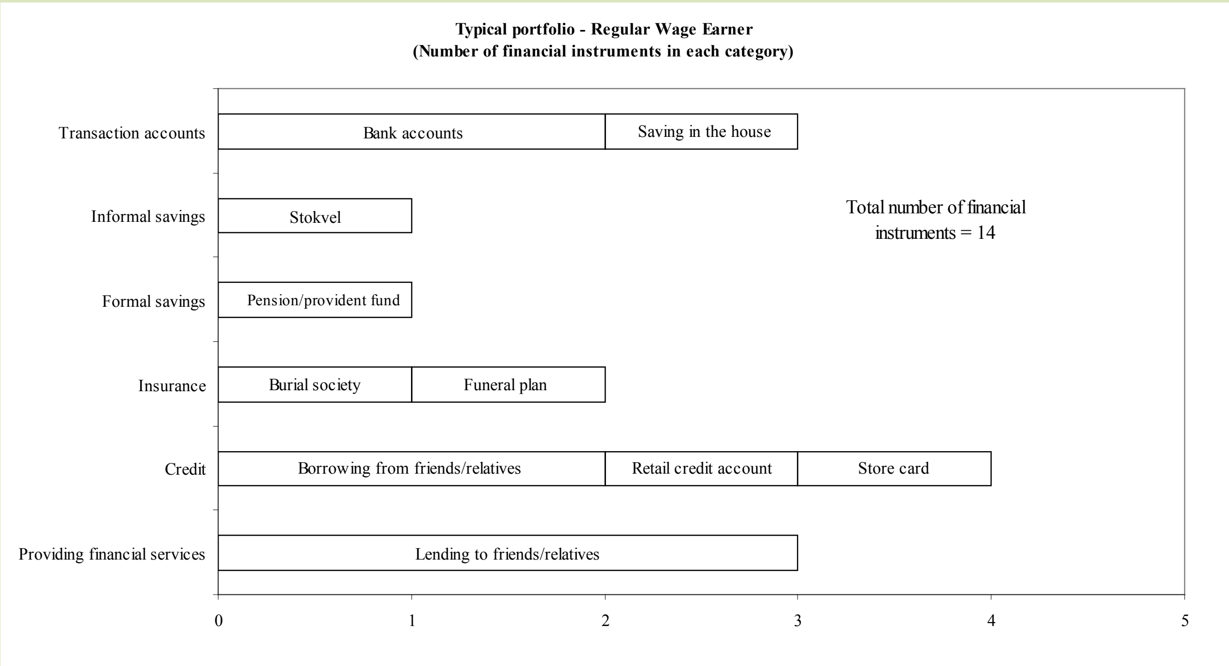
Observation: Livelihood does not dictate how many instruments households use, but might make a difference to what kind of instruments they use

As Table 1 shows, Regular Wages Earners and Grant Recipients dominate the sample, accounting for three quarters of the households. These profiles are different to the rest of the profiles because they derive most of their income from the dominant source, that is, 81% of income for the Regular Wage Earners and 77% of income for Grant Recipients. So we might say that these two profiles are a more "pure" reflection of that particular livelihood.

Both profiles use a total of 14 different financial instruments – but there are distinct differences in the circumstances of the households. First, Regular Wages Earners are largely urban households, while Grant Recipients are largely rural. Second, Regular Wage Earners are at the top of the monthly income range, while Grant Recipients are at the bottom of the monthly income range. Third, average net worth of Regular Wage Earners is twice that of Grant Recipients. And, most importantly, the portfolios of instruments shown on the next two pages are different, reflecting a distinct difference in cash flow management. One observation is that Grant Recipient portfolios are dominated by informal instruments, while Regular Wage Earners have more formal financial instrument portfolios.

There are several important points to note about Regular Wage Earners. These are the only households that appear to use two high-level formal financial instruments: an employer provided pension or provident fund; and a store credit card (like for Woolworths, Edgars, etc). They also frequently use the more expensive funeral plans, as well as a burial society. It is important to note that, despite their relatively better off status, they will still participate in informal borrowing and lending, *stokvels* and burial societies. The case study of Kenneth Ndola on the next page demonstrates a number of these points.

Figure 1: Typical portfolio – Regular Wage Earner



Regular wage earners have more formal financial instruments, even a bond for a home like the one above.

Case study[3]: Regular Wage Earner

KENNETH NDOLA is a well respected 81 year old man living in a block of flats in Langa with his 30 year old daughter, 20 year old son, and 2 year old granddaughter. He has a job as a caretaker in a block of flats in a different suburb, where he is paid R1000 a month. This supplements a pension from his previous job of R1000 a month. His daughter also has a job earning about R1000 a month. Kenneth's assets are dominated by his home and livestock in the Eastern Cape. Kenneth is very interesting to us because several items in his financial portfolio stand out. He is one of two respondents in the study who has unit trusts – we were surprised to hear about this, but he showed us the statements and, sure enough, he has invested R17 000 in an income fund with one of the well-known South African investment houses.

Kenneth and his daughter each have a bank account. Despite his sophisticated unit trusts, his financial instruments are primarily informal. He belongs to two burial societies – one based in his flat community and the other based in his rural home. His most prized financial instrument is his informal *stokvel*. He has belonged to this *stokvel* for a long time, and he would rather borrow money than not make his payments to it. In fact, he did just that during the study year (see below). This *stokvel* works on a rotating basis. Each member in turn receives a payment from the other members. How much he contributes depends on how much each member gave him last time. So if he was given R2 000 by a member when it was his turn, he would need to give, say, R2 200 when it was this person's turn.

This *stokvel* can generate very high returns - the highest earner to date received R92 000! Kenneth did run into problems during the study year because his daughter had died and he did not get the money he expected from her *stokvel* to pay for the funeral. So he had to contribute from his own money. Unfortunately, he also had to contribute money to his own *stokvel* at that time, so he borrowed R500 each from two separate friends. Later in the year, he also had problems getting his pension paid out for a month or two. Luckily, his son picked up some casual work during this time to help them through this period.

[3] Note: The names of all the respondents in this issue of Financial Diaries *Focus Notes* have been changed to protect their identities.

Observation: Grant recipients have more debt instruments and higher debt service

Grant Recipients have a very different debt profile to Regular Wage Earners. Grant Recipient portfolios are dominated by debt instruments. Informal borrowing from relatives, neighbours and friends, credit at the local store and even credit from informal sellers of goods. On average, over the Financial Diaries study year, they borrow four times from friends/relatives, have two credit accounts (often with informal sellers) and take credit once from the local store.

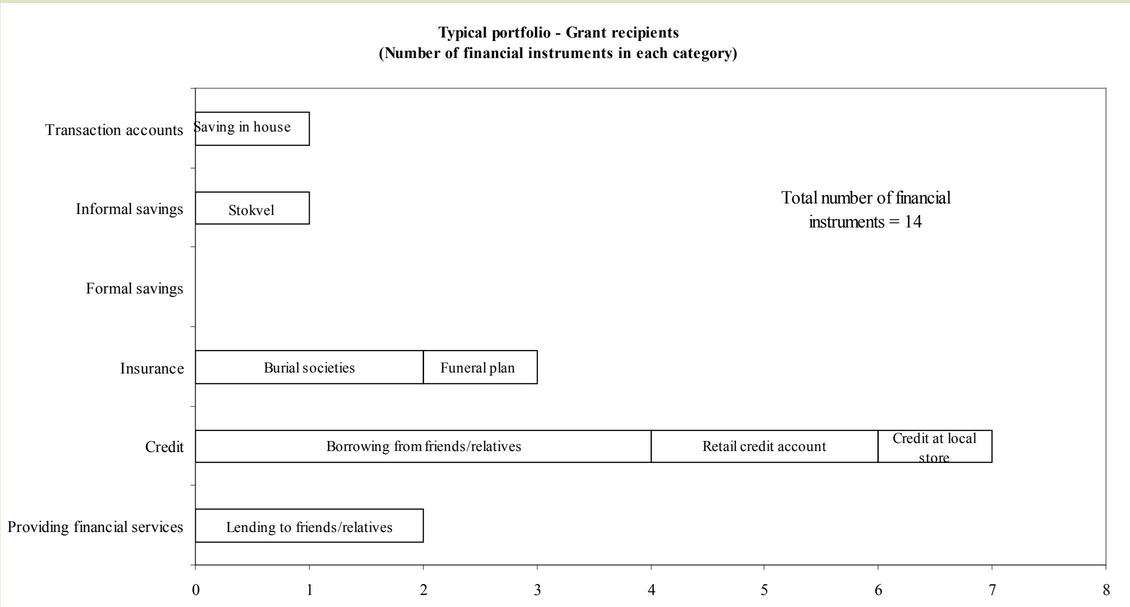
This shows up in their debt service ratios as well as their financial portfolios – grant recipients have the highest debt service to income ratio of all the livelihood profiles[4]. This suggests that grant recipients struggle to manage cash flow, and that most of their financial management consists of making money last until the next grant payment.

If we only looked at the debt/equity ratio, a stock rather than a flow variable, we would have missed this point. As Table 1 shows, the debt/equity ratio for Grant Recipient households is often as low as 23% which is in line with the debt/equity ratios of other profiles except for Business Owners and Casual Workers. However, this ratio reflects that these households are relatively asset rich, with homes and livestock that they likely inherited from their relatives. The high debt service ratio reveals another piece of information: that they are cash flow poor. Although their debt levels are not high relative to their assets, these assets (such as a rural home) are not always liquid and they do not help households service their debt. Moreover, informal credit usually tends to have relatively high interest rates – so it is more expensive than the debt stock of most Regular Wage Earners.

Why would Grant Recipients have a more difficult time managing cash flow than, say, Business Owners or Casual Workers, who have far more uncertain income streams? One reason may be the number of people that those grants are supporting. Income per capita for Grant Recipient households is R398, compared to R660 and R724 for Business Owners and Casual Workers. But this is a similar income per capita to those living off remittances from relatives. So some other, unidentified factor must be responsible. It may be perhaps that having a regular stream of income gives Grant Recipients the confidence to participate more fully in the financial economy than those with a less certain stream of income. However, there is not enough evidence to do more than speculate on this point.

The two profiles on the next page on a Grant Recipient household and a household dependent on Remittances from Relatives highlight some of these points.

Figure 2: Typical portfolio – Grant recipients



[4] *Focus Note:* Debt and Household Finance shows that many highly indebted households are grant recipient households.

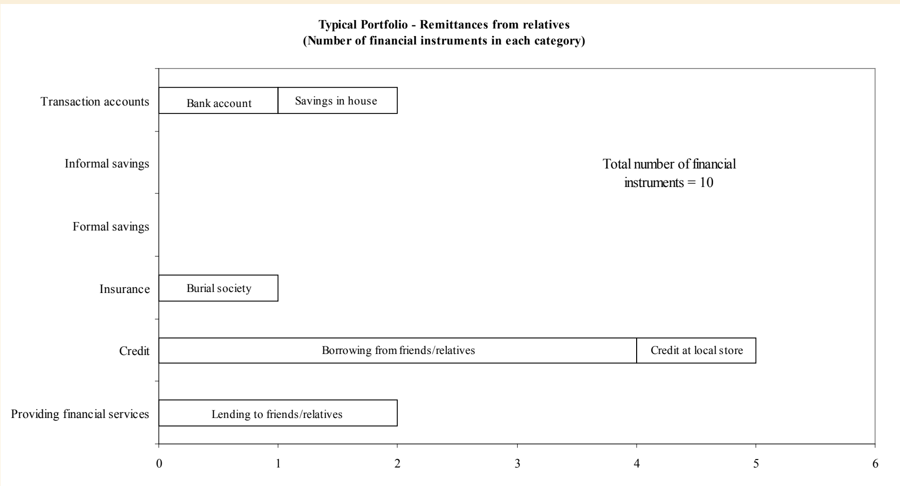
Case study: Rural Grant Recipient

MAMNGWEVU is a 73 year old widow who stays with her 50 year old son, 23 year old grandson and 12 year old grandson. Neither of the adult men work, and the older one causes her a great deal of trouble. He expects to live off her old age grant (R740 per month) and the income from four school children who rent rooms from her at R60 each a month. He often asks her for money for cigarettes and liquor. She has another son who lives elsewhere and is working, who tries to give her money. She has another grandson who is also a problem – he was in a fight in which two people were beaten to death and is wanted by the police. Often during the year, she worried about money. Twice she was concerned about having enough money to go to the doctor. Yet, at the beginning of 2004, she hired a builder to build an additional room, but he did not complete the job.

Grant recipients, even in rural areas, have higher debt service and more debt instruments than other livelihood groups

A significant part of Mamngwevu's financial portfolio is in credit instruments – though she does have a bank account, a burial society and a *stokvel*. During the year, she had credit from 2 informal sellers, credit at 3 local spaza shops, a mashonisa loan, loans from 5 people and she took back-to-back loans from *stokvels* 12 times. Clearly, she has a difficult time managing her cash flow and she uses credit to augment her income and expenditure patterns. She has a very high debt service ratio of 48%, one of the highest in the Financial Diaries sample.

Figure 3: Typical portfolio – Remittances from relatives



Case study: Couple dependent on daughter's income

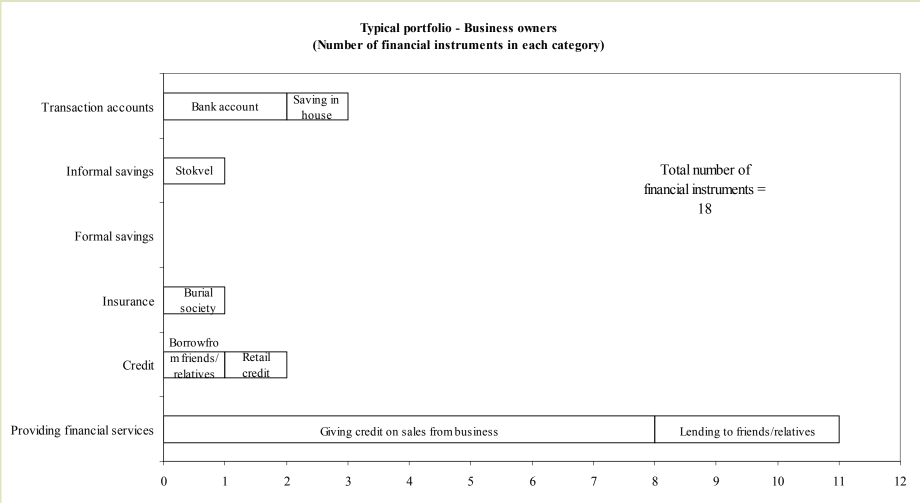
LUCY (43) and **HENRY** (49) are an older married couple who live in Diepsloot in an RDP (Reconstruction and Development Programme) house with their two grandchildren. The mother of the children who lives elsewhere receives a child grant for them and works at casual jobs as well. She supports all of them, as Henry recently fell ill and could not work. He used to have a job where he was earning R700 per week, so he was doing relatively well. Most of the time that we knew them, they received a combination of groceries and cash (about R300 per month) from the mother of their children. Their financial portfolio was somewhat sparse. Henry has a bank account into which he saved his salary. Lucy belongs to a *stokvel*. They took credit at the local store once and borrowed from a neighbour once over the year. Towards the end of the study year, he received two payments of R2200 each from Unemployment Insurance. They planned to use that and future payouts to build a wall around their house and to add on two rooms.

Observation: Business owners are providers of credit, not takers of credit

A much smaller group (only 7% of our sample) receive the majority of income from small businesses. These are largely urban households, and they are still relatively poor, with average monthly income of only R1964 a month. These households have the lowest debt service level of the sample, and the second lowest debt/equity ratio.

Business owners have the highest number of financial instruments of any profile but they concentrate on providing financial services rather than taking them. What this means is that they provided credit to customers, on average eight times over the study year, and they lent out to family, friends and neighbours an average of three times over the study year. Yet they use a minimal number of debt instruments and have the lowest debt service ratio of all the livelihood profiles. The case study below shows that these instruments are important for even survivalist businesses, like those selling sheep intestines.

Figure 5: Typical portfolio – Business owners



Nomsa's sheep intestine stall – Business owners give more credit than other livelihood groups.

Case study: Urban Business Owner

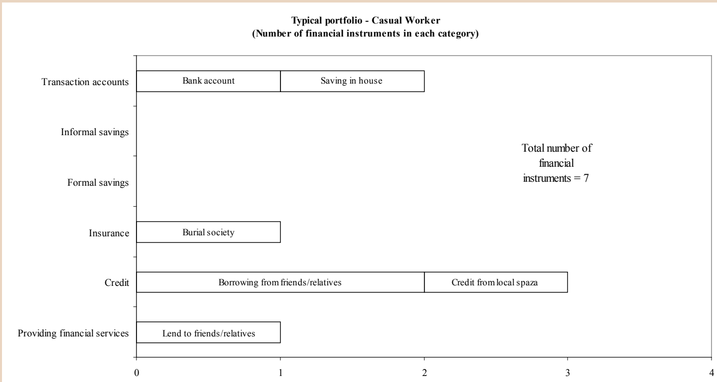
NOMSA is a 45 year old woman living with her daughter, and niece and nephew in the hostels in Langa. She earns nearly all of their income by cooking and selling sheep intestines on the street, but she is lucky if she manages to earn R1000 a month. She saves money in the house, and belongs to a burial society. She also belongs to 3 *stokvels*, all of which are accumulating stokvels to save for Christmas. She takes credit from the local spaza shop, but her predominant form of financial management is giving credit to customers. She says she gave credit to six customers over the year, but we wonder whether she keeps track of who owes her money. Her neighbour, another one of our respondents, also sells sheep intestines but does not give credit, and she earns more than Nomsa.[5]

Observation: Casual Workers have the lowest number of instruments and the most difficulty building assets

Another small part – only 5% – of the sample is made up those who receive most of their income from casual work. These households have an average monthly income of R1316 and net worth of only R19 529, the lowest of all the livelihood profiles. They do not have large holdings of assets, but neither do they take on a lot of debt; they have the lowest debt/equity ratio and the second lowest debt service ratio.

The financial portfolios of Casual Workers reflect the most simple of the financial portfolios, with only 7 financial instruments. Although the majority of them do have a bank account their portfolios are dominated by informal instruments. In general, the households in this profile get by with very few financial instruments.

Figure 6: Typical portfolio – Casual worker



Casual workers have less financial instruments than other livelihood groups.

[5] *Focus Note*: The Financial Management of Survivalist Businesses shows that a well-run credit book is crucial to the sustainability of a survivalist business.

Case study: Urban Casual Worker

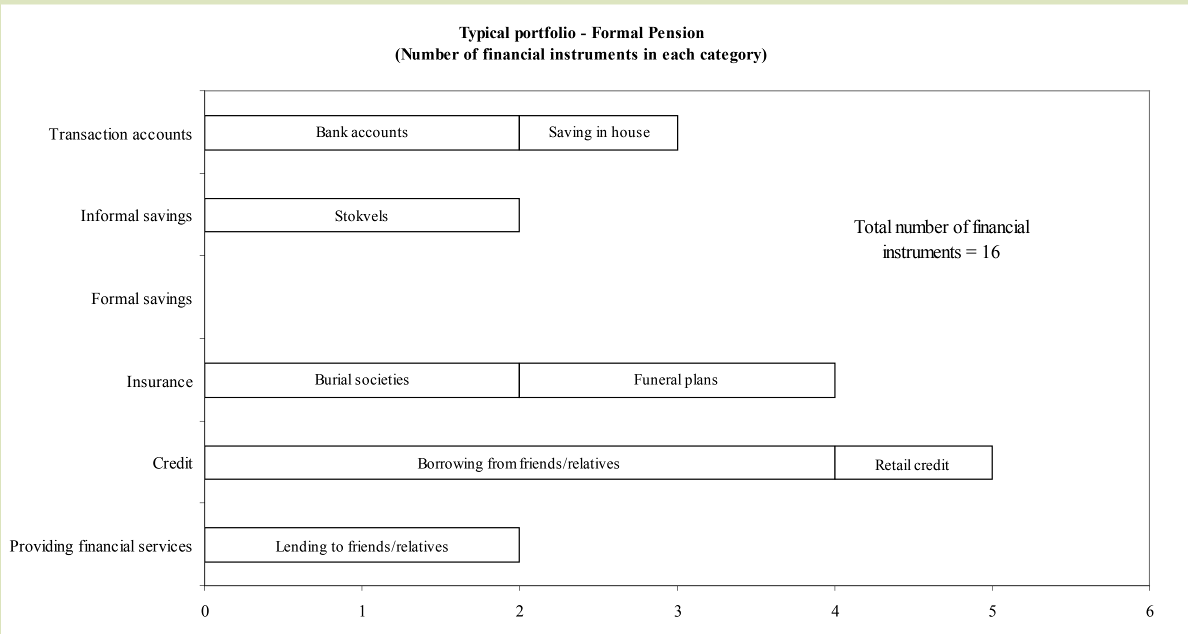
LUVO is a 33 year old man living alone in one of Langa's hostels, renting a bed in a room with several other men. He lives alone but his brother, who owns a spaza shop, lives near by and helps him financially. Every day he goes to the nearby industrial area and tries to find casual work. During the year he earned, on average, about R277 a month from his casual work and he was given R150 by his brother. Despite his vulnerable circumstances, we found that Luvo was quite happy to share whatever he had. He also lent people money when he had it. When his father became ill, an uncle gave Luvo money to send his father for medication. When he found a more permanent part time job in September, he opened a bank account to save money so he could go home for Christmas. He uses a money guard and he is in a burial society, but he owed them money for much of the year. To save him from being kicked out of the burial society, his uncle gave him money to pay off the debt.

Observation: Formal Pension Recipients are the most affluent in the community and are sophisticated financial managers. They also provide the financial backbone of a larger extended family circle

A very small group (only 3% of the sample) receive most of their income from a formal pension plan. This sample is made up entirely of women, all living in Lugangeni, and most of them were previously teachers or nurses. They are better off than most of their neighbours, with an average monthly income of R4 381 and a massive net worth of R796 733 on average. Although their higher income status gives them access to more credit, they do not have extremely large debt service (12%) or debt/equity ratios (23%).

As the case study below shows, many of these households seem to use their wealth not only for their own comfort but for that of their family. One of these households has used a variety of retirement annuities to put her grandchildren through school. They also remain quite engaged in informal community financial instruments. On average, they belong to two *stokvels* and two burial societies. They also maintain membership in an average of two formal funeral plans, often to cover the funerals of their families. Given the needs of less affluent families, these households are often the backbone of a larger extended family structure.

Figure 6: Typical portfolio – Pension recipients



Case study: Retired rural nurse

NOMTHOLO is a 61 year old retired woman who lives with her 31 year old unemployed niece in a big house in Lugangeni. This is a woman who has earned all her life as a nurse and managed her money exceptionally well. We calculated her net worth to be about R1 million. She holds R400 000 in a unit trust, and the rest in real estate. She has a large and newly renovated home in Lugangeni, as well as a house in Umtata. During the year, she sold her house in Umtata for about R150 000 and has kept the money in her bank account.

She receives two pensions every month – one from her work and one as the spouse of her deceased husband. Together they add up to about R7000 per month. She also gets remittances from her daughter but these are forced. Every month she asks to "borrow" money and then she gives it back to her daughter when she needs it. She found that she was bored not working, so she started working as a nurse again on a 6 month contract, where she earns R2 244 per month.

She holds an array of financial instruments. She belongs to several burial societies and funeral plans to cover both her funeral and those of her children and grandchildren. She has credit accounts for the furniture in her new house. She has two bank accounts and a unit trust. She also has life insurance, as well as car and vehicle insurance. She has held retirement annuities that have paid out and supported both her home building and the education of her grandchildren.

Her wealth provides a backstop for many of her extended family. During the study year, she contributed R6 000 towards relative's funerals and traditional feasts. In addition, she gave roughly R15 000 in goods or cash to her children over the course of the study year, to cover a variety of needs such as paying the family of a women her son made pregnant but did not marry; paying for the school and medical needs of a grandson who has cerebral palsy; and paying for the clothing of grandchildren.

Observation: More similar than different?

Although this exercise has highlighted some important connections between livelihoods and financial management, it is worth noting that there are some important similarities across the range of profiles. All households borrow and lend within their families and communities; all households have burial societies; and all households keep money at home. This suggests there are important patterns at work, guiding financial preferences: community, traditions and financial opportunities.

We have not even begun to analyse these households in terms of financial "personalities" governed by values and risk preferences. These further investigations will unlock more observations about the financial lives of the poor and help us to better understand how to meet their needs.