

# Informal Finance - Mapping Global Savings and Lending Practices



To understand the potential gains from formal banking, we must first understand the risks and returns that the poor face from financial-service options in the informal sector. Yet, while informal financial products dominate the financial lives of the poor, we have scant data and analysis on either informal savings or informal debt. This project aims to fill that gap by collecting detailed information on a range of informal financial vehicles from countries across various regions of the world.

## Policy Issue

This study aims to improve our understanding of several long-standing puzzles about the demand and supply of both informal moneylending and savings.

### *Informal Moneylending*

Although MFIs and other formal financial institutions now offer and deliver loan services to the poor, many of these poor still continue to access capital informally, notably from moneylenders. Often referred to as “loan sharks”, informal moneylenders are frequently criticized for lending money at exorbitantly high interest rates and preying on poor people in dire situations. Are the observed high interest rates actually usurious, or do they simply reflect high lending costs? Which characteristics of informal loans account for the fact that even in areas with high formal finance saturation, informal lending is still prevalent? What are the characteristics of informal lending models? The fact that we are not as of yet capable of confidently answering these important questions points to a knowledge gap. This lack of systematic data across many countries in the developing world to facilitate studying informal loans and comparing them to their counterparts offered in the formal sector is at odds with the fact that informal financial products dominate the financial lives of the poor. The study aims to collect accurate information by using innovative survey instruments, to compare the costs of formal and informal lending services available to the poor.

### *Informal Savings*

Poor households typically use a myriad of informal financial mechanisms to satisfy diverse financial needs. However, informal financial options alone are unable to meet all of a household’s savings



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#### COUNTRY

Global

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#### PROGRAM AREA

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needs, and households often report that having access to a savings account is their greatest financial need (Kendall, 2010). Informal schemes often entail high risk and as a consequence tend to discourage medium and long-term accumulation. Few existing studies analyze the risks and returns of using informal financial tools, and the factors that influence behaviors in different contexts. One of the reasons for this dearth in knowledge is the difficulty in collecting accurate information. This explorative study aims to create and test high-quality instruments to collect both quantitative and qualitative data about informal savings practices, in order to analyze the contours of demand in these markets, evaluate the risks and returns that the poor face when using the products offered to them, and understand the heterogeneity in informal savings arrangements around the world.

## Evaluation Context

Seventeen summer interns spent three months in the field in several developing countries - Bangladesh, India, Philippines, Peru, Ghana, Malawi, Mali, Morocco, Rwanda, Ethiopia, Tanzania, Uganda and Senegal - in order to collect quantitative and qualitative data. Of this group, six of them participated in the third year of ongoing research about informal moneylending, while the remaining eleven started up an explorative study about informal savings, taking the first steps for further research.

## Details of the Intervention

### *Informal Moneylending*

From 2009 to 2011, IPA has been gathering data in eleven countries on the business practices of informal moneylenders operating in both urban and rural areas. The crux of this work has been qualitative surveys of moneylenders and their clients with a focus on activities and business cycles. In the spring of 2011, we conducted pilot studies to test various methods of tracking the daily activities of informal lenders, such as in-person shadowing, asking lenders to maintain daily diaries, text-message communication, and other technology-based instruments. These ongoing methods returned more accurate data than self-reported surveys. Over the summer of 2011, we expanded the information-gathering process, resulting in a more precise measure of the direct and opportunity costs of informal lending. Additionally, we interviewed formal financial organizations, which compete with informal services in order to further understand the relative costs and benefits of different forms of finance. These interviews covered organizations such as MFIs, banks, and other loan associations. In the process, information on ROSCAs and other informal loan and savings vehicles was also collected.

### *Informal Savings*

2011 was the first year of data collection on informal savings. In each country, interns visited three areas - rural, semi-urban and urban - and interviewed several respondents from different backgrounds, with the goal of developing an understanding of how the poor manage household income and expenditure flows, in terms of how they make decisions, which savings instruments they use and what their costs and returns are. The information was gathered both through informal interviews and a structured survey instrument, the latter being piloted all along the summer. It was continually updated with improvements and will serve as a basis for further research.

In Summer 2012 we conducted a second wave of data collection. Sixteen interns conducted research on informal savings in eleven different countries using quantitative and ethnographic methodologies. In the quantitative component, interns interviewed respondents from a representative sample to develop an understanding of which informal and formal savings instruments people use in each country, and assessed what are the costs, risks and returns associated with each of these instruments. The information was gathered through a structured survey instrument that was piloted in the beginning of the summer. In the ethnographic component, interns conducted a mix of immersion, observation, semi-formal interviews and focus groups in order to further understand savings behavior in the study locations. Interns focused in particular on research gaps that had been highlighted in the context of existing projects.

## Results and Policy Lessons

Results Forthcoming.