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People Need More Than Just Microfinance: Evidence from Pakistan

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Abstract

In the last few decades, microcredit has become the predominant strategy for alleviating poverty from the world, while microsavings and all other forms of business development services have been overlooked. There is a need to understand whether microcredit is the only constraint to the development of rural households or whether range of a financial and non-financial services keep the poor away from enjoying the basic amenities of life. This study will assess the need for business development services and their growing importance among rural households of financial services including microsavings, payment services and remittances. The study aims at revealing the constraints that the rural poor people face other than finance such as access to markets, price information and skills training. In general, the objective of the study is to develop a comprehensive model of poverty alleviation. The study is conducted in an effort to find missing links and bridges these gaps which have not been addressed in previous poverty alleviation strategies. There is a need to understand the problems of rural households and then develop a new local business model that addresses their issues at a local level.

Keywords: Financial Services, Non-financial Services, Microsavings, Business Development Services, Community Savings

1. Introduction

Poverty headcount had never been an easy task, especially, when different countries uses different measures and poverty lines. Ravallion et al. (2008) finds that 25 percent population of the developing countries was living below the poverty line in 2005. The World Bank report 2004 suggests that poverty incidence is higher in rural areas than in urban areas since rural households rely mostly on agriculture as their main source of income. However, poor rural households diversify their economic activities into non-farm income generating activities such as basket weaving, pottery, retail shops and embroidery to avoid economic shocks (Haggblade et al., 2002). Yet this does not mean that these non-farm income generating activities would automatically help the rural poor to break the vicious circle of poverty (Haggbladea et al., 2010). Therefore, poverty reduction strategies must focus on rural areas since an increase in the income of rural households would have the greatest impact on poverty reduction.

Although in last few years the number of NGOs and banks which offer financial services in low income communities of Pakistan has increased in number. But, their services have been limited to a small amount of loans and to some extent microsavings services. On one hand, it is argued that lending a small amount of loans (microcredit) will eradicate the poverty while others argue that it is not the microcredit only but provision of diverse range of financial services and business development services that can better help the poor to come out of this vicious circle in a sustainable way (Dunford, 2001).

The paper is an effort to find missing links and bridges these gaps which have not been addressed in previous poverty alleviation strategies. In particular, this study will assess the need for (a) business development services (BDS) and (b) microsavings among rural households of Pakistan.

The paper is organized in five sections where a literature review on microsavings and BDS is presented in section 2. Section 3 describes research methodology and section 4 focuses on the main findings of the study. Finally, section 5 concludes the study.

2. Literature Review

In the current world where majority of the people live in a state of poverty, microfinance shines as a ray of hope for many poor people to improve their lives. In the last three decades, the microfinance industry has gained vast acceptance and popularity. The World Bank estimated, in 2004, that over 16 million poor clients are being served by more than 7000 MFIs1. Microfinance offers financial services to the poor people who were left "unbanked" because of their lack of collateral. Giving the poor the ability to avail themselves of small loans for investment in business or for smooth consumption has been recognized as one of the effective ways to break the vicious circle of poverty. Various studies have demonstrated that, once given the opportunity, poor clients of microfinance were able to diversify their economic risk (Littlefield et al., 2003).

Even after more than 30 years of micro financing efforts, there is a gap between supply and demand for microfinance services. Millions of families are still lacking saving accounts facilities and other financial services like transfer payments. Some analysts believe that microfinance institutions solely focus on disbursing loans and that industry has tried to force every saver to be a borrower. As a result, MFIs miss the segment of the poor population "who may wish to save but do not necessarily wish to borrow" Buckley (1997).

"While the credit bias in development finance from the 1960s onwards has never given way to a savings bias, despite a widespread demand for savings services among the poor, savings are no longer 'the forgotten half of rural finance'. [. . .] However not all donors have learned that lesson: that the poor need both savings and credit services; but more of the poor need savings deposit facilities than credit." (Harper and Arora, 2005)

Adams and Von-Pischke (1992) argued that "lack of funds was not the most important problem faced by most small farmers. Product prices, land tenure, modern input costs and availability, low yields, and risk turned out to be more important factors limiting small farmer development." Rural areas are characterized by a lack of infrastructure, lack of price information, limited market access, relatively undiversified economy and low skilled people. Because of these constraints, poor people are excluded from equal access to economic opportunities (Narayan, 2002). "Access to financial services forms a fundamental basis on which many of the other essential interventions depend (Littlefield et al., 2003)".

Harper (2003) also argued in the same style that "the efficient provision of financial services to the poor will not resolve constraints originating from a lack of skills or access to markets. Credit and savings will only assist the clients served by allowing them a greater range of choices to survive in the informal sector based on their abilities and hard work. This type of intervention should not be constructed as a panacea for the poor." Practitioners, policy-makers and governments should realize that no one can ever rise above the poverty line just by grants, donations, subsidized credit and charitable checks. The time has come to end the spoon feeding attitude and to empower the poor to free themselves from the shackles of poverty. Narayan's (2002) empowerment model consists of three major elements which increase the freedom of choice and action of the poor: (i) access to information, (ii) inclusion/participation and (iii) organizational capacity. The provision for training in business management skills, creating links to markets, providing required information in time, helping to create demand market, providing marketing skills, and up to date technological insight can all help the poor to overcome the disadvantages of being scattered and disorganized.

There is a need to get poor people involved in all of the processes leading to poverty alleviation. Their active participation will act as a driving force and enable them to come out of the vicious circle of poverty. Saving mobilization is one of the ways that can help overcome poverty. Saving is not a new idea in microfinance; it has already been in place. MFIs currently have compulsory saving products, but clients view this as a cost of credit rather than a saving service.

In the beginning, microcredit was associated with a few myths; among them the poor are bad borrowers is the most common. This has proved baseless, as their incredible resilience has astonished both practitioners and research scholars. The same seems to be happening with micro saving: practitioners were suspicious about the saving capacity of the poor, but experiences from Asia to Africa have proven this myth to be baseless (Harper, 2003). For microloans, the MFIs need creditworthy clients but, for micro saving, clients ask for trustworthy institutions (Robinson, 2004). "For the poor, secure and accessible savings are at least as important as loans" (Harper and Arora, 2005).

The exclusion of poor people from the banking sector should be a major concern for policy makers. A number of studies are available on the saving methods of poor people in different parts of the world. Literature suggests that cash at home, (Rotating Savings and Credit Associations)ROSCA, keeping livestock as money, purchasing raw materials for construction, hoarding grain for food security and lending money to friends or relatives are some of the common saving practices (Robinson, 2004; Rutherford, 2000; Hannig and Wisniwski, 1999; Isabel, 2004). These saving practices in the informal system raise a fundamental question of why people opt for informal saving mechanism over formal and what factors contribute to their decision for not saving with banks.

3. Research Objectives

1. To understand the saving capacity of rural households and what instruments they use to raise lump-sum amounts.
2. To investigate what factors prevent rural households from using formal banking services and to find out whether their improvement will assist rural households switching from informal to formal banking?

3. To understand what major rural development constraints (links to markets, price information, and knowledge of new technologies and availability of credit) rural households are facing.

4. Methodology

The structured questionnaire was administered at the individual household level to collect data. Contacts were made with the district headquarter administrations and the union councils of the respective villages to acquire authentic and reliable information. Thus, with the extended support of the respective councilors of each village, the study was conducted in the stipulated time. The empirical survey of the current study is limited to the rural areas of two districts of the Islamic Republic of Pakistan, Dera Ghazi Khan and Jhelum, to evaluate the need of financial and non financial services of the rural people there.

A sample was selected in two stages. In the first stage, villages/mouzas/dehs in rural areas were treated as primary sampling units (PSU). All PSUs that have more than 20 households were extracted from the original available list of each district. The sample PSUs between districts were then divided proportionally to the number of PSUs in each district. Then sample PSUs within the district were selected by a simple random sampling technique. Then households (secondary sample units - SSUs) were randomly selected from the PSUs. The list of villages/mouzas/dehs was obtained from the Population Census department of Pakistan. Each of these villages / mouzas / dehs was treated as a separate PSU. 30 PSUs were selected from both the districts and 300 individuals (10 individuals from each PSU) were interviewed. The sample of 300 households covers age groups of 19 - 81 years. The head of each household was interviewed, which limits the participation of females in the sample, as in Pakistani culture, men are considered to be the heads of households. The marital status reflects the general trend of elderly men as the heads of households. 85% of the respondents were married, while single and widowed were 8% and 7% respectively.

5. Empirical Findings

5.1. Understand the saving capacity of rural households and what instruments they use to raise lump-sum amounts.

The perception that the rural poor are not able to save, owing to the fact that they are too poor to do so has been shattered by the present study. When participants of the study were asked how they could accumulate Rs.30000/- in a year, whether by saving or by winning a lottery, the overwhelming majority, in fact 77.3%, of the study participants were of the view that they could easily manage the required amount through savings. This leads to main question of this study: how do the poor turn their tiny incomes into large lump-sums? Rural households actively use three ways to accumulate savings and manage their small income.

- Saving up - Setting aside cash for future
- Saving down - taking a lump-sum in the form of loan first, then paying it back over a specified period of time.
- Saving through - making regular savings that turn into large lump-sums of cash at some point of time but receive this amount before they have deposited the entire amount.

Since the rural poor face certain constraints (that will be discussed in the next finding) which prevent them from using formal saving services, they primarily save through informal savings mechanism. In-kind and at-home saving accounted for 61% of the total savings among the study participants. Moreover, the rural poor do not rely on one type of saving but save through multiple ways at the same time. This shows that they are good economic managers and diversify their tiny amounts in a variety of informal savings mechanisms to sustain themselves through economic shocks.

5.1.1. Saving up by the Rural Poor

Savings in-kind: Empirical evidence shows that every second rural household (53%) uses this form of saving. It serves three purposes in rural households: first, livestock is the most liquid asset and can be sold in time of need, second, rural households supplement their meager income by selling products like milk, butter and ghee, so it is the source of extra income for rural households, third, it offers the food security as well. Savings at-home: Saving at home is the second most popular approach used by rural people. Every third respondent (31.7%) reported that they saved at home. Home savings are considered to be highly liquid form of savings with zero transaction cost. Bank: The third saving up device that is used by the rural poor is the bank. 22% of the interviewees said that they also kept their savings in bank. It was strongly observed, however, during discussion with the interviewees that banks are not used as a means of raising lump-sum amount. Instead, banks are mainly used when they already have a large lump-sum of cash (eg. proceeds from sale of crop or livestock) and want to keep that at some safe and secure place. Every second household (49.7%) has a bank account but these accounts are involved in few transactions. Banks are only considered a secure means of storing large sums of cash until it is needed.

5.1.2. Saving Down by the Rural Poor

During the survey it was found that rural households mainly use three devices (Friends and relatives, banks and moneylenders) to raise lump sums in the saving down mechanism. Loan from friends and relatives: The trend of lending between friends and relatives is quite common in rural settings. In fact, 55% of the study respondents reported that in times of need their first choice for credit would be friends and relatives. They lend to each other expecting that, if they help by lending someone cash or in-kind today, the other will also do the same at their time of need. Bank: On the 'saving down' aspect of banks, 27% of the study participants opted for banks as their first choice of loan source. These loans are given for productive purposes, particularly to farmers during sowing season. Most of the respondents believe that loan from banks are out of their reach. Moneylender: About 6% of the respondents admitted that they take loans from moneylenders. The reason given by the participants is that it is an easily available facility and that they did not have to make much effort or need documentation. However, since Pakistan is an Islamic country and interest is prohibited in Islamic Law, those who lend on interest earn a bad reputation in their communities. Interestingly, most of the interviewees were not ready to admit their own involvement in taking loans from moneylenders, but when they were asked if people were doing business with moneylenders in the community, the answer was, " too many people take loans from moneylenders but we do not."

5.1.3. Saving Through by the Rural Poor

Committee: Committee (ROSCA) is the most commonly used device of the rural people in the 'saving through' mechanism. The amount saved in regular deposits is available to them at certain events. 22% of the interviewees used this device to raise lump-sum amounts. The Committee system is the bank for rural people. 22% of the respondents use banks for their savings and the same percent of rural households use the committee system to deposit their regular savings.

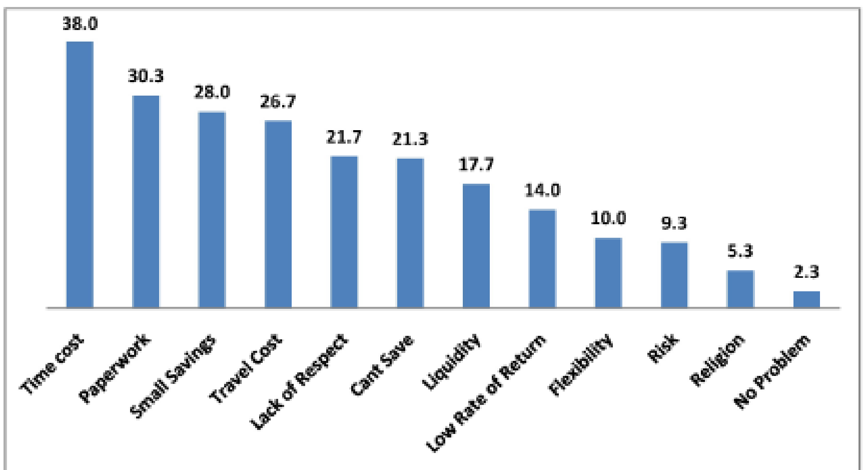
5.2. Investigate what factors prevent rural households from using formal banking services and to find out whether their improvement will assist rural households switching from informal to formal banking?

Rural households have considerable saving capacity and their saving practices in the informal sector indicate their willingness to save. This study has identified a number of factors which prevent them from saving in the formal financial institutions. They save in informal saving systems, particularly in non-financial form such as livestock. If these factors are addressed successfully, the informal savings of the rural poor could be brought into the formal financial sector (see Figure 1).

5.2.1. Time Cost

The study has established that the 'time cost' is the most important factor in the saving decisions of rural households. Available empirical studies suggest that accessibility is the main reason for not saving in banks, but this study has further observed that rural households are not ready to use bank facilities even if banks are in close proximity. More specifically, the study has established that the 3T (travel time, deposit time and drawing time) are more of the rural household concern.

Figure 1: Factors that Stops the Rural Households from Saving in Banks



Source: Authoer's own Survey

The inefficiency of bank staff is a major reason that stops rural households from saving in banks. It is worth mentioning that 51% of the respondents have not ever open the bank account. While 49% of the respondents who have their bank accounts experiencing a 19 min mean deposit time and 31 min mean drawing time, along with a 26 minutes mean travel time. 51% of the respondents said that it takes less than 15 minutes to reach the bank, whereas 38% of the respondents said that it takes more than half an hour to reach the bank. It was reported that the deposit time for 11% of the rural households and drawing time for 16% of the rural households is more than 30 minutes. In few cases, it was reported that transaction time in banks takes even more than an hour.

5.2.2. Paperwork

Both, illiterate and those who have completed sixteen years of education have cited the paper work as a hurdle to save in banks, 23% and 21% respectively. This study has established that, irrespective of education class, paperwork in the banking system is highly intimidating for all the rural household savers. In fact, 30.3% (see figure 1)of the respondents reported paperwork as the second biggest hurdle to saving in banks. Intimidating procedure and complex paperwork held the people out of the formal financial system (Snowden, 1989). The same reasons held true for saving services. The highly bureaucratic environment in banks requires paperwork which on one hand reduces the efficiency of the banking system and increases the transaction cost and, on the other hand, this also causes an increase in transaction time which is cumbersome for clients and one of the main reason for not saving in banks.

5.2.3. Small Amount of Savings

As it was expected, poor rural people have meager saving capacity and conventional financial institutions are not ready to "bank" them. This study established that the third major hurdle to saving in banks is that the small amount of savings of rural poor people are not accepted by the banks. 28% of the interviewees show their concern that banks are for the rich people. Banks do not welcome clients with small amounts.

5.2.4. Travel Cost

Empirical findings (26.7%) indicate that banks are situated far away from rural households. They have to bear high travel costs if they wish to avail themselves of the the saving facilities in banks. It takes 20 to 30 minutes to reach a bank, which is not so far but in 3 to 4 Km. range, and it costs Rs. 20/- to 40/- per visit to the bank. Such high travel costs turns the poor to save in informal saving mechanisms instead. This study has established that for 21% of the rural savers, the nearest available bank is 3 to 4 Km. from their home. This state of affairs becomes more tedious for 31% of rural households for whom a bank is only accessible at least 5 Kms from their home. The cost of transportation for 30% of the respondent is more than Rs. 20 per visit, which is as much as many savers are able to save at a time. However, accessibility is not the only barrier. Results from the survey indicates that even in cases where the distance to be covered to reach banks was even less than a kilometer, only 15% of clients were saving in banks. About 56% of the people still preferred to save in-kind.

5.2.5. Lack of Respect

The study found that 21.7% of the respondents are reluctant to visit banks because of the behavior of the bank staff. When interviewees were asked to rank the behavior of the bank staff in one to five point scale, 24.3% of the respondents rated their behavior either 'bad' or 'very bad'. 19.7% of the respondents reported that the behavior of the people in the informal savings mechanism is 'very good' as compared to 9.7% in banks. People living in rural areas have strong interpersonal relationships. Information passes on from one person to another quite swiftly and one negative incident conveys a strong message to the whole community against saving in banks.

5.2.6. Liquidity

Rural poor savers demand mainly liquid saving products. 17.7% of the rural savers argued that liquidity constraints stopped them from saving in banks. Interestingly, banks are already offering current account facilities that permit withdrawals with no limitations. Two points are of more interest which make current accounts, illiquid for rural savers: (i) If rural savers need to draw amount from the current account then (s)he needs to be careful that the remaining balance must not be less than the minimum balance requirement. (ii) If rural savers need to draw more cash than Rs.25000/- from the account, they need to pay tax on that amount.

5.2.7. Low Rate of Return

Given a fair rate of return, 34.3% of the rural savers would like to deposit their savings in banks. Whereas, for overwhelming majority (65.7%) of rural savers, the rate of return is not the major determinant to save in banks. This finding differs from the observation made by the earlier studies by Harper (2003), Hannig and Wisniwski (1999) that rate of return is a major factor in an individual's saving decisions. Yet, this finding is in line with the observation made by the Mayada et al. (1995) which showed that the absence of interest rates is more attractive to the rural savers in the Muslim community.

5.2.8. Flexibility

This study has established that flexibility, ready access to savings and the opportunity to deposit frequently in convenient timing with small and irregular amounts, is another demand of 7% of rural households.

5.2.9. Risk

Safety of the deposits is a prerequisite for any saving service. The rural poor cannot even afford to think of putting their hard won savings at risk. 9.3% of the respondents fear losing their savings in banks. Failure of large banks in the recent past has resulted in the loss of millions of small savings accounts. This has shaken confidence in banks. This study has established that 20% of rural savers have lost some of their savings either in formal or informal savings systems. The poor rural saver is at risk for theft at home, fraud in committee systems or bank. The research revealed that 24% of those who have lost some of their savings are in the formal sector (banks) and 47% of the clients who have lost some of their saving are in the in-kind saving method. Evidence indicates that the rural poor do not have any safer or reliable saving services. However, the respondents were asked which saving method they believe to be less risky, only 54% respondents were of the view that saving in banks was more secure. Although 47% of the people who have lost some of their savings were using the in-kind saving method, 28.3% of the people felt more secure with in-kind saving and termed it less risky than any other saving method.

5.2.10. Religion

"Islamic finance" refers to the financial services that are offered in complete compliance to Islamic principles. In this system, conventional interest based transactions on loan or savings are strictly prohibited. This study has established that 5.3% of rural people term the conventional banking system Un-Islamic and do not want to transact with it. During the study, instead of 'interest' the world 'profit' was used. This cosmetic change of words was made in an effort to make interest more acceptable to rural people but, even then, 39% of the respondents believed that this kind of 'profit' was not allowed in religion Islam. Conventional banking systems (including MFIs) offer only interest-based saving accounts, there is no inherent incentive for this segment of the population to have saving accounts in banks at all.

5.2. Understand what major rural development constraints (links to markets, price information, knowledge of new technologies and availability of credit) rural households are facing.

Rural households are engaged in different economic activities such as farming, livestock, labor and remittances but one of the activities has been the major contributor in earning to livelihoods. Crop farming is one of the primary sources of income for the overwhelming majority of 72.3% of surveyed area. Contrary to the prevailing belief that agriculture is the sole source of income for people living in rural areas; rural households diversify their economic activities and income sources. Besides farming, they are also engaged in non-farm economic activities. Most of their secondary economic activities are limited to local markets.

This links their profits to local conditions. 71.2% of the respondents said that they have one or two animals at home. Traditional produce from these animals, either processed or unprocessed, are traded to earn money to keep body and soul together, but this trade is limited within rural households and informal markets. Rural households have identified top most barriers to their economic development as (i)lack of funds, 57% (ii)landlords, 48% (iii)underdeveloped infrastructure, 35% (iv)lack of information, 25% and v)lack of access to markets 24%.

When the respondents were asked, what information or assistance they needed for economic development, the response suggested that they needed to link the local economy with broader markets, availability of funds, a market intelligence system that includes price information and rural development services.

5.3.1. Market Intelligence System

The market intelligence system (MIS) is demanded by most rural households. This system includes price information, technological innovation and in time information about the new opportunities in the market. 22% of the people in the study have expressed their concern that they are not able to get market price. Rural small farm holders get information about the present market price only when they have already sold their crop to middle men at a cheaper rate. 25% of the respondents demanded better and improved practices, and information about new varieties that produce higher yield.

5.3.2. Links to Market and Value Chain

About 31% of the people demanded links to markets that is to link the local, fragmented markets to the big regional and national markets. Poor infrastructure, unreliable transport, isolated and small markets push up the transaction costs and cost of production of the people living in rural areas. Thus, it is observed that linking the farmer and the rural economy is important for the development of rural households. Rural households sell their harvest as soon as it is ready because they do not have any storage capacity. Upgrading the technical capacity of the rural farmer by linking them to markets, giving them storage space, and teaching them to grade products is necessary. Interestingly, it has emerged from the study that 11% of male respondents want economic facilities for their women. The community expressed the need for a sewing and embroidery school for women where they could learn and contribute to the betterment of household. This finding suggests that women in rural areas can be major economic actors, but these skills are limited to local markets.

6. Conclusion

Lack of capital is one reason for poverty but no means the only one. In conclusion to this study, it is argued that microfinance has a strong role in poverty alleviation. However, it is underlined that poverty alleviation policy initiatives must not only broaden the concept of microfinance to include a richer menu of products, but also should help the people to overcome their non-financial constraints, links to markets, lack of information etc. The survey results can be categorized into two broad categories: The survey revealed that the rural people have a desire for saving accounts. They need access to a diverse range of financial services. The analysis reveals that rural people have saving capacity and are engaged in diverse forms of informal saving instruments, such as livestock. Investment in domestic animals may not be considered a normal saving strategy but poor rural people are left with no other option but to save in such a risky ventures. With little or irregular income, poor rural people are seldom able to obtain financial services from formal financial institutions i.e. banks. The rural poor cannot obtain small loans, safeguard their small savings, or receive amounts from relatives living and working abroad through the existing formal financial system. Available data indicates that the rural poor are forced to save in livestock because banks are not ready to mobilize their small savings. Although the existence of financial constraints cannot be denied, there are some non-financial constraints as well that usually have not given way to development interventions. Evidence suggests that lack of infrastructure, poor information sources and underdeveloped, inefficient markets all hold back rural communities from reaching their full potential. Such problems cannot be solved by giving access to financial services through microfinance initiatives and need to be addressed directly. On the whole, it is very simple and logical to conclude that, while access to microcredit is important to rural, there is little doubt that rural people face many risks, and in these cases, well designed micro saving products and business development services could have an important development impact.

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