How do the Poor Deal with Risk?
Lessons from Portfolios of the Poor: How the World's Poor Live on $2 a Day

Financial Access Initiative

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The Financial Access Initiative is a consortium of researchers at New York University, Harvard, Yale and Innovations for Poverty Action.

NYU Wagner Graduate School
295 Lafayette Street, 2nd Floor
New York, NY 10012-9604

T: 212.998.7523
F: 212.995.4162
E: contact@financialaccess.org

www.financialaccess.org

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This brief offers insight into the ways poor households manage risks. Based on the financial diaries research outlined in Portfolios of the Poor: How the World's Poor Live on $2 a Day, this brief outlines the formal and informal risk management tools used by poor households in Bangladesh, India and South Africa, such as insurance and savings, and examines how these tools can be improved to help the poor mitigate risk and plan for the future.

POOR HOUSEHOLDS ARE MORE VULNERABLE TO RISK

Being poor isn't just about living on $1 or $2 a day; it is also about dealing with the fact that on some days, you have more and some days much less. Coping with the ups and downs of irregular and unpredictable incomes is an overlooked but fundamental challenge. The poor also struggle with a lack of financial tools that could help them weather emergencies and protect their livelihoods. Their inability to access risk mitigation tools can force them to sell assets, take on high-interest loans, or exhaust meager savings—pushing them further into poverty.

> **How lack of financial tools becomes a health emergency**
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> Feizal's ten-member family lived on a household monthly income of $36, largely comprised of his earnings as a mobile aluminum trader and supplemented by his son's earnings as a tailor's apprentice. Midway through the research year, Feizal fractured his thighbone, terminating the family's main source of income. Feizal did not have insurance, so due to cost concerns, he initially sought treatment from traditional doctors—paid for by his son's wage advances and bank savings. Showing little signs of improvement three months after the accident, Feizal's father brought him to an urban doctor who used more modern methods, where the family exhausted nearly all of their bank savings to pay for diagnostic tests. Feizal was able to work eight months after the accident. In the end, the costs of the accident—both the direct cost of treatment and the indirect cost of lost earnings—were far greater than they would have been had Feizal paid for high quality treatment (either through insurance or on his own) in the first place.

Health crises and other emergencies can push poor households further into poverty. The table below shows the range of crises that poor households faced during the financial diaries research year. Illness affected 50% of diary households in Bangladesh, and 42% of households in India. Funerals were the number one event causing a financial emergency in South Africa—81% of households were impacted.

Table 1: Most Frequent Events Causing a Financial Emergency, by Country, with the Percentage of Country Sample Affected at Least Once during the Study Year

Bangladesh *42 households*		India *48 households*		South Africa *152 households*	
Event	%	Event	%	Event	%
Serious injury or illness	50	Serious injury or illness	42	Funeral of family outside the household	81
Did not receive expected income	24	Loss of crop or livestock	38	Serious injury or illness	10
Fire/loss of home or property	19	Loss of regular job	10	Funeral of member of the household	7
Loss of crop or livestock	7	Theft	4	Theft	7
Business failure	7	Abandonment or divorce	4	Violent crime	4
Cheated/cash loss	7	Serious harassment by officials	4	Fire/loss of home or property	3

Source: Portfolios of the Poor, Table 3.1, p. 68

CURRENT SOLUTIONS ARE INCOMPLETE

Dealing with emergencies means being able to pull together adequate financing at the right moment. The diary households used insurance, both formal and informal, to mitigate risk.

Table 2: Types of Insurance Products used by Diary Households in India and Bangladesh

	FORMAL			INFORMAL
Coverage	*Life*	*Life*	*Credit-Life*	*Village Insurance*
Carrier	State (Life Insurance Corporation)	Private Insurers	Microfinance Institutions	Households
Country	India	Bangladesh	Bangladesh	India & Bangladesh
Policy	Quarterly or biannual premiums based on age. Recovered savings with profits if term completed.	Weekly or monthly premiums. Reclaimed savings with profits if terms completed.	Payment built into price of the loan. Debt-forgiveness upon death.	Reciprocal gifts or flexible loans between relatives.
% of diary households	15%	19%	≈50%	n/a

Source: Financial Access Initiative, from Portfolios of the Poor, Chapter 3

As we saw in Table 1, 81% of diary households in South Africa had to find financing to pay for a funeral during the research year. Funeral insurance is a good example of how poor households draw on both formal and informal insurance schemes. About 80% of diary households in South Africa had at least one funeral insurance scheme of some kind—formal or informal—and most respondents had more than one. Funeral coverage made up 10% of the financial instruments held in household portfolios, with families spending an average of 3% of gross monthly income for all of their funeral coverage instruments. Researchers reported that formal funeral plans complemented rather than displaced traditional burial societies because burial societies provided social benefits as well as financial ones and all sources of income were necessary to pay the full funeral costs.

Table 3: Types of Funeral Insurance in South Africa

	FORMAL			INFORMAL
Carrier	Regulated financial Companies	Funeral parlors	Burial Societies	Less-Structured Burial Societies
Payment/ Payout	Monthly premiums. Upon death, company paid out in form of cash lump sum.	Monthly premiums. Upon death, fixed set of goods, services, and/or cash to heirs.	Monthly premiums. Upon death, relatives received a set payout of cash, in-kind support, or both.	Transactions only at time of death. Relied heavily on in-kind support where members promised to give a set amount when death occurred.
% of diarists	26%	24%	57%	n/a

Source: Financial Access Initiative, from Portfolios of the Poor, Chapter 3

NEW IDEAS FOR HELPING POOR HOUSEHOLDS DEAL WITH RISK

Partial coverage

Partial coverage can be useful: the poor address emergencies by patching together funds from different sources. Effective solutions are those that best contribute to the mix. The portfolio approach suggests that it is not necessary to insure against an entire problem in order to improve the well-being of poor communities. Partial solutions are welcome. Commercially viable, comprehensive health insurance for poor households would most likely require expensive premium payments. Instead, there could be a substantial demand for cheaper, but more limited, partial health coverage, such as prescription drug benefits or catastrophic health coverage. Funeral insurance in South Africa usually covers a portion of total funeral expenses, while still providing meaningful funds at critical times.

> **Patching together funds from a variety of sources: Xoliswa, South Africa**
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> When Xoliswa's mother, Busisiwe, died, the funeral cost was over $2,400. Busisiwe held insurance plans with a funeral parlor and a burial society. Coverage with the funeral parlor included the coffin, undertaker's fee, and the cost of collecting the body, worth about $465; as well as a cash pay out of $464 for the funeral feast. The burial society paid out a cash sum of $155. Xoliswa also received $155 in cash from Busisiwe's two savings clubs. Relatives contributed $297 in cash and 13 goats. Of the total cost of the funeral, insurance covered 45%, cash, in-kind contributions from relatives covered 49%, and savings club payments covered the remaining 6%.

Product Design

Insurance is the answer for some big problems like health crises, but high deductibles and co-insurance can have unintended consequences. "Moral hazard" is the tendency of individuals to change their health seeking behavior once they have access to insurance. Health insurers attempt to reduce moral hazard by including co-payments and deductibles in the policy to avoid insuring the entire cost. However, these devices might not have the intended outcome with poor households: if doctor's fees, diagnostic tests, and treatment must be paid for directly and there is little cash to spare, treatment may be avoided until health deteriorates seriously, possibly beyond recovery. Additionally, insurers must consider the convenience and affordability of premiums. For the poor, the timing and size of installments can matter as much as the total cost of the policy.

Beyond insurance

Coping with risk doesn't always mean relying on insurance. Financial devices such as savings and loan accounts can help mitigate a broad range of crises. Insurance is typically tied to specific adverse events. The fungibility of money is an advantage of savings and loan devices absent in insurance. A loan issued to provide working capital to a business can be diverted to deal with an emergency, whereas an insurance premium will only be paid out against an insured event. In theory, this requirement shouldn't bother poor households: if the risk is real and the coverage represents good value, they should buy it. In practice, however, poor households may reason that given their limited resources, they are better off using general-purpose tools because the insured risk may never occur. For these reasons, insurance coverage attached to savings and loan products, as in the case of credit-life insurance and life-endowment savings, may appeal to poor households more than a generous portfolio of policies insuring against each and every risk.