



# USEFUL LUMP SUMS: MICROENTERPRISE REVENUE MANAGEMENT AND ITS POTENTIAL FOR BANKS

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- ▲ The median microentrepreneur household had to handle \$2.31 of business-related cash to generate \$1 in income.
- ▲ Only about 10 percent of lump sum purchases coincided with an inflow from a formal financial source.
- ▲ Microentrepreneur households made over 40% of lump-sum purchases during weeks when regular household cash flow could not cover the cost. That situation occurred about once every 11 weeks in a median amount of \$125 (more than twice weekly median income).

**MICROENTREPRENEURS IN CENTRAL MALAWI** frequently experience the need to amass what scholars have termed “usefully large lump sums” (Rutherford, 2000) of cash to finance inventory purchases and other business expenses. At the same time, these microentrepreneurs cycle through large amounts of cash, handling \$2 to generate every \$1 of income. Ideally, these two phenomena – the routine handling of large volumes of cash and the equally routine need for usefully large lump sums of it – would be synchronized. But a recent study by Microfinance Opportunities (MFO) shows that this is not in fact how the flow occurs.

The microentrepreneurs in the MFO study routinely experienced both “good” weeks with strong sales and income and “bad” weeks without. They also frequently experienced weeks with no income at all. But they could seldom predict whether any given week would be a good one or a bad one, much less time the need for the “usefully large lump sums” to coincide with the good weeks. They also faced significant challenges in setting aside the surplus from good weeks as savings. The MFO study suggests that a market opportunity exists for banks to develop financial products that could help resolve the chronic mismatch between cash in and cash out.

MFO’s study ran from July 2008 – December 2009 among hundreds of low-income Malawians. It used the Financial Diaries methodology, tracking every transaction for 172 households and 257 individuals each week over that 18-month period. The Financial Diaries yielded almost 231,000 records documenting the economic behavior of the participants in great detail – every purchase, sale, and exchange of goods and services, inclusive of all financial services transactions.<sup>1</sup>

#### THE DOMINANT ROLE OF SELF-EMPLOYMENT

The largest segment of the sample (43 percent) identified their primary livelihood as microentrepreneurship, and the transactional data bear this out: the top sources of income were all sales items (e.g., of food, clothing, household goods). At 37 percent of the sample, farming, essentially another form of self-employment, was a close second in terms of self-reported primary occupation.

It is worth noting that many respondent households earned income through more than one form of self-employment (e.g., many self-

reported farmers were also microentrepreneurs, and vice versa). Furthermore, not every respondent’s self-reported primary occupation necessarily reflected his dominant source of income. For example, few respondents self-identified as day laborers, even when that work represented a major share of income, probably because a day laborer is held in lower social esteem than a farmer.

But regardless of the specific source or combination of sources, it was self-employment, with all the challenges of erratic cash flow that implies, which accounted for the income of the great majority of respondents. Only 17 percent held regular salaried jobs.

#### AND ITS IMPLICATIONS FOR CASH MANAGEMENT

Because Central Malawi is primarily a cash economy, all households in this study, whether they contained a microentrepreneur or not, handled large amounts of cash. The median household (that household whose income placed it in the center of the sample, with half of the others having greater income and the other half having lower) had a weekly mean income of PPP \$55.<sup>2</sup> But that household handled, on average, \$187 in cash per week. The median household’s business flows were, on average, \$108 per week (excluding loans, loan repayments, and savings account deposits and withdrawals).

The median microentrepreneur’s household, however, handled even more money: \$210 in cash per week, with median business flows of \$131 and median income of \$60. In other words, the median microentrepreneur household had to handle \$2.31 of business-related cash to generate \$1 in income, a ratio well above the sample as a whole.

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<sup>1</sup> The reader should bear two points in mind regarding MFO’s calculations of financial services transactions. The first is that keeping cash on one’s person or hidden at home (which the MFO study shorthanded as “mattress money”) was routine practice among the Diaries participants. But they were extremely reluctant to discuss the amount or even the existence of their mattress money even after many months of rapport had built up with MFO researchers. The second is that the MFO report employs income calculations based on exchanges of cash. It does not include valuations of gifts received in kind nor valuations of home-gardened food consumed within the household (nor deductions for gifts given or inputs used in the garden). The study was interested in the role of financial services in helping people manage money, and so focused on cash. We recognize that this is not the only perspective on income.

<sup>2</sup> Conversion rate used throughout this Brief is 66.76 Malawi kwacha to 1 purchasing power parity dollar.

TABLE 1 - BUSINESS LUMP-SUM EXPENDITURES

TYPE OF EXPENDITURE	NUMBER	AMOUNT
<b>Working Capital</b>		
Agriculture	110	\$55,071
Business	681	\$338,864
Clothing	562	\$164,203
Other	84	\$40,064
Construction	43	\$3,834
Employment	59	\$16,976
Food	1,190	\$269,425
Fuel	170	\$4,913
Health	83	\$8,352
Household item	328	\$80,600
Transportation	125	\$48,004
<b>Working Capital Total</b>	<b>3,435</b>	<b>\$1,030,307</b>
<b>Fixed Capital</b>	<b>10</b>	<b>\$10,732</b>
<b>Emergencies</b>	<b>12</b>	<b>\$4,175</b>
<b>Total Business Lump Sums</b>	<b>3,457</b>	<b>\$1,045,214</b>

### BUSINESS LUMP-SUM EXPENDITURES

The data for microentrepreneurs reveal that almost all of their business lump-sum expenditures went for working capital, primarily to replenish inventory. Related to this, microentrepreneurs spent money on transportation to enable them to travel to markets to buy or sell goods. There were strikingly few lump-sum expenditures on fixed assets: of the ten fixed asset purchases reported, \$10,732 allocated to that category, a full \$9,000 was attributable to a single transaction, the purchase of a minibus by one of the sample's most well-off respondents.

### PAYING FOR LUMP SUM NEEDS

In general, to meet lump-sum needs, anyone has essentially four choices.

- Earn sufficient income to be able to cover the amount out of normal cash flow;
- Accumulate cash at home over time in an amount sufficient to cover the lump sum when it comes;
- Get a cash gift from a friend or relative to cover the cost; or
- Use a formal or informal financial service either to borrow the lump-sum amount or to withdraw it from savings.

The MFO study households employed all four methods.

It is important to note that lump-sum expenses routinely arose in study households without a microentrepreneur. But what is true for the study households in general – that cash flow was frequently insufficient to meet lump-sum needs – held even truer for microentrepreneur households. The median amount of the business lump-sum purchases made by microentrepreneurs was \$125, more than twice their weekly median income. To bridge the gap, microentrepreneurs did what everyone else did: pulled money from secret stashes at home, got cash from friends or family (whether as loans or gifts), or, less often, went to the bank.

### IMPLICATIONS FOR THE FINANCIAL SERVICE INDUSTRY

The MFO Financial Diaries research focused in part on the role of Opportunity International Bank of Malawi (OIBM) and other commercial banks, seeking to understand the extent to which low-income Malawians used formal financial services compared with informal alternatives. The study found that about 10 percent of the lump-sum purchases coincided with some sort of inflow (a loan or a cash withdrawal from savings) from a formal financial source. So OIBM and other commercial banks played a role, but a relatively small one. Moreover, in many cases, the bank services were employed in addition to, rather than in lieu of, the informal financial sources that dominated the economic lives of the study subjects.

These data suggest an ample market for the services that banks provide. The study's households handle a lot of cash. They regularly need to accumulate lump sums that exceed their weekly incomes. And even though many of these lump-sum exchanges are of sufficiently high value to represent viable business for banks, the study households currently rely with overwhelming frequency on money saved up at home, cash gifts, and other informal financial services. In other words, banks at the moment are barely tapping a market that they are capable of serving.

For Malawian microentrepreneurs specifically, business-related bridge loans or flexible lines of credit are two possibilities on the credit side. Alternatively, flexible savings products could help microentrepreneurs save to meet inventory-restocking and other recurring needs.

Based on the study data, useful financial products for the sample's microentrepreneurs would be designed:

- With a weekly payback/pay in schedule
- With the opportunity to access the money in multiple locations
- In an amount sufficient to cover expenditures that are twice their weekly income, every three months or so. (Microentrepreneur households made just over 40% of the lump-sum purchases during weeks when the household's regular cash flow could not cover the cost of that purchase. They encountered that situation about once every 11 weeks for business purchases, in a median amount of \$125, more than twice their weekly median income.)

In sum, microentrepreneurship is a major feature of the Central Malawian economy – and strikingly high cash flow, combined with

a persistent need for large outlays of cash, is a major feature of how microentrepreneurs do business. There is a strong market opportunity for services that help accumulate the “usefully large sums” that informal sources strain to cover but banks could manage quite easily.

### **FORMAL VS. INFORMAL & THE UNEXPECTED ALLURE OF PAPERWORK**

Replacing informal financing with formal financing is not a simple or one-dimensional task. The informal options offer a huge advantage in terms of convenience. In addition, the mutual exchange of cash gifts both reflects and reinforces important social ties. The banks must trump these factors with their own advantages, including security, reliability, interest paid on savings, and more reasonable fees on loans.

As evident in the Diaries study, another surprising advantage that banks may hold over informal alternatives is the provision of regular bank statements. When MFO was initially recruiting study participants, some successful microentrepreneurs balked because they felt themselves to be too busy. Over time, however, the monthly reports that the project team distributed to participants became highly valued. These were summaries of business income and expenses, customized and generated for each household.

The research plan had always entailed distribution of these reports, but the response was noteworthy. Participants were eager to learn more about the budgeting and profitability of their businesses via the monthly reports, explaining that the reports gave them insights into financial management they could get no other way. Many participants in fact described the reports as their primary reason for remaining in the study.

A traditional bank statement of course does not provide the same granular level of transactional detail. However, based on the intensity of the respondents' enthusiasm, any degree of useful customization a bank can generate without over-straining back-office systems might prove a powerful marketing tool.

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*This brief is based on Cash In, Cash Out: Financial Transactions and Access to Finance in Malawi (January 2011) by Guy Stuart, Michael Ferguson, and Monique Cohen. The original report can be downloaded in PDF form from [www.microfinanceopportunities.org](http://www.microfinanceopportunities.org). The Financial Diaries are part of the Financial Services Assessment project, information about which can be found on the web at <http://www.fsassessment.umd.edu/>*

This study is part of the **Financial Services Assessment** project, undertaken by the IRIS Center at the University of Maryland and its partner, Microfinance Opportunities. The goal is to assess the impact of grants provided by the Bill and Melinda Gates Foundation to microfinance organizations for the development of innovations in financial services.

[www.fsassessment.umd.edu](http://www.fsassessment.umd.edu)

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**Dr. Monique Cohen**, Founder and President of Microfinance Opportunities, is a leading international authority on the use of financial services by the poor. She currently supervises a team which employs the innovative Financial Diaries methodology to assess financial behaviors and preferences in Kenya and Malawi. Dr. Cohen spearheaded the groundbreaking “Global Financial Education Program” which builds the financial capabilities of the poor using a range of media tools and workshops. Together with MicroSave she developed “Listening to Clients,” a visual and interactive market research microfinance training toolkit. Dr. Cohen is on multiple advisory committees, speaks regularly at microfinance conferences around the world, and is widely published. Prior to founding Microfinance Opportunities, she led the “Assessing the Impact of Microenterprise Services” (AIMS) project at USAID.

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#### REPORT SERIES

This report is part of a series that will be generated by the Financial Services Assessment project. The reports are disseminated to a broad audience including microfinance institutions and practitioners, donors, commercial and private-sector partners, policymakers, and researchers.

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