What Motivates Low Income Earners to Save Money?

by Leena Im and Camille Busette, PhD

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EARN Research Brief

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INTRODUCTION

In general, Individual Development Account (IDA) programs — which match the savings of low income workers toward investment in certain assets — have been advanced under the assumption that the act of savings to acquire a significant asset sets in motion a critical path for low-income mobility into the middle class. Hence, IDA programs encourage the purchase of a home, the pursuit of a post-secondary education, or the launching of a small business. Each of these assets can be leveraged in the current U.S. tax environment to gain additional assets that help provide a foundation for modest but sustainable wealth creation.

While IDAs have been successful asset-creation vehicles, IDA programs have been less focused on identifying the behavioral mechanisms which encourage low-income workers to save and to do so over a sustained period of time.

The purpose of this research brief is to answer the following question: what motivates low income earners to start saving money and to continue savings behavior over time? We want to identify these mechanisms because when public policy is appropriately informed, behavioral incentives can be used to create savings outcomes for retirement, education, or other types of investment that can foster significant social and economic outcomes.

In 2009, EARN, an award-winning, nationally recognized non-profit which has supported the savings aspirations of nearly 3,000 clients, conducted the first of a series of interview-based inquiries into the behavioral dimensions of savings behaviors for low income workers. We specifically focused on the reasons behind starting, continuing, and disrupting savings strategies. We asked alumni of our IDA program to identify those elements of their expectations, preferences, and behaviors that were changed by the IDA program, and which ones were particularly relevant to their attitudes towards savings. The most significant outcome of the study was the identification of primary and supporting mechanisms that help low income workers begin and sustain a lasting discipline and pattern of saving money even after participating in an incentive-based savings program.

EARN's research shows that our clients were motivated to continue a pattern of savings behavior when they realized they could save money within their current income stream, which typically happened after participation in financial management training. Clients were further motivated when they believed that their own savings efforts led them to amass enough resources to acquire an asset such as a home or post-secondary education —powerfully symbolic assets in the U.S. denoting economic success.

EARN also found that clients' interaction with EARN over the length of the IDA program, usually 2.5 years, was their first prolonged engagement with financial services organizations and that such interaction served to increase confidence in interacting with financial services organizations.

BACKGROUND

Individuals save for two primary reasons. First, savings provide an economic safety net by transferring resources from the present to the future. Consequently, individuals are prepared to face income shocks without borrowing or selling assets. Second, saving leads to accumulation of financial wealth that enables individuals to improve their living standard through asset accumulation.

First introduced by Sherraden (1988), Individual Development Accounts are matched savings accounts for low-income individuals. The theory behind IDAs is that low-income earners have access to income and consumption smoothing welfare tools, but these tools do not offer sustained wealth accumulation that is necessary to move out of poverty. As Sherraden (1991) noted, IDAs offer these earners a means to "plan ahead, set aside savings, and invest in a more secure future" (p.1).

IDA accounts serve as an institutional savings mechanism for low-income individuals who do not have access to middle- and high-income asset accumulation instruments such as IRAs. To qualify for EARN's IDA program, individuals must meet income requirements and live in San Francisco. An individual's savings can be used for post-secondary education, capital for a microenterprise, or a home purchase. Other IDA programs allow for other uses as well. Currently, there are over 500 IDA programs across 49 states (Edwards & Mason, 2003).

While researchers have examined the program characteristics, participant saving rates, and broader policy implications, the effects on savings patterns after exiting the program and the social capital implications of IDA programs have not received much attention.

As IDA programs including EARN's continue to grow, it is important to understand the lasting effects of participating in such programs, and of accruing savings and developing assets through IDAs. This paper serves as a first step in such a discussion and aims to answer three main questions:

1) Do alumni continue to save beyond the program?
2) What are the mechanisms and circumstances that allow for continued savings?
3) Does participating in an IDA program correlate with social capital development?

RESEARCH METHODOLOGY

EARN has a total of 218 alumni who have successfully completed the matched savings program and have used 100% of their funds. 126 alumni were contacted for interviews, and 30 of them agreed to be interviewed by phone or in person. EARN will continue these interviews to build a large and growing sample over time. We developed an interview script and protocol used for both phone and in-person interviews. The interviews were semi-structured, in-depth interviews that explored a wide range of topics about the participant's asset accumulation patterns and perceptions before, during, and after the IDA program. The interviews also included questions about community involvement, self-image, family perceptions, and future goals.

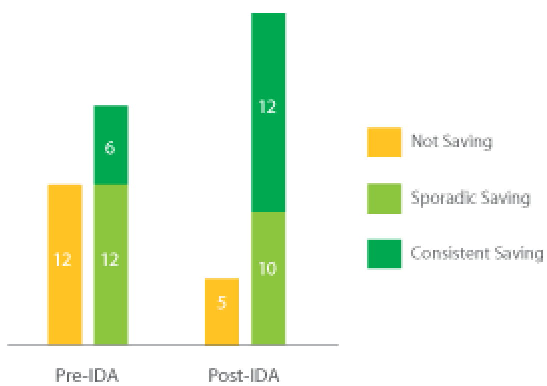
FINDINGS

Savings Behaviors

Our results show that alumni can continue to save beyond involvement in EARN's IDA program and that there are specific IDA-related mechanisms that lead to sustained economic and social behavior changes. Furthermore, we found that participation in an IDA program results in specific types of social capital development that leave participants ready to access and more readily engage with nonprofits, other social support services, and financial institutions.

The chart below demonstrates the shifts in overall savings behavior.

Shifts in Savings Behavior Pre- & Post-IDA (n=30)



Since exiting the program, twenty-five of the thirty alumni save, as opposed to eighteen who were saving prior to program participation. When we further disaggregate the data, we find that fifteen of the current savers are consistent savers (only six before the program) and ten are sporadic savers (twelve before the program).

At the time of joining the IDA, twelve (40%) of the alumni interviewed were non-savers and did not have any other assets.[1] Another twelve (40%) of the alumni were sporadic savers who saved (either in bank accounts or at home) when they had money left after paying their bills and other expenses. The last six (20%) were consistent savers who used automatic withdrawals or other regular means to save money each month. Three of the consistent savers were saving for their first home and three were saving for emergency funds.

After finishing their IDA program, there is a noticeable shift in the distribution of savings behaviors. 83% of those interviewed are saving money, either regularly or sporadically. 50% save regularly. We find that only five (17%) are not saving currently. Of these five alumni, one is not saving because she is still enrolled in school and using her income for tuition and living expenses. However, she plans to start saving once she finishes school and notes that she is "excited to start saving again." Three are currently unemployed; however, one of the unemployed alumni saved $2000 in the first three years after finishing her IDA. She used this money to pay for expenses when she was laid off.[2]

There is some variance within the savers, with some saving sporadically and others saving consistently. Ten sporadic savers were either sporadic savers or non-savers before joining the program. Most of them cite income limitations as an impediment to consistent saving since exiting the program. Five of the ten sporadic savers have emergency funds; they distinguish these funds from other savings that are meant for asset development. For example, one alumnus has an emergency account and saved separately to purchase a car for his business. Fifteen interviewees (50%) are consistent savers. Four of these consistent savers did not save before starting the IDA program,[3] five were consistent savers before the program, and the rest were sporadic savers. It is interesting to note that while most of the consistent savers save monthly, one saves her income tax refund ($2,500 to $3,000) every year for her daughter's college fund, and another saves using another type of matched savings account offered by EARN.

There are extreme examples in each category of savers. There are non-savers who state that they

[1] One interviewee noted that she had a 401k, but used the funds when she was laid off.

[2] Two of the unemployed alumni used to be regular or sporadic savers who have stopped saving because they are unemployed. The others non-savers were also non-savers before the program.

[3] Two used their IDAs to pay for their education and the other two used their IDAs to buy a home.

will never save again unless they have a matching incentive as they did in the program. On the other end, one consistent saver has a very successful business, has set up a trust fund for his daughter, and has a "sizeable" savings cushion for his business development and personal use.

PATTERNS BEHIND SUSTAINED SAVINGS

Saving within Current Income Streams

Participation in the IDA program has enduring effects — there are several program elements that contributed to financial behavior transformation and sustained savings.

Both consistent and sporadic savers expressed the view that their savings behavior resulted from a realization that they could save regardless of their limited income. Importantly, this sentiment appears to be a drastic shift in the savers' perception of their ability to save and build assets for future wealth.

Interviewees also mentioned the importance of the restriction on early withdrawal of funds as a factor which fostered discipline in spending and savings. One interviewee stated that she "realized my budget would be fine without it [the money she was depositing into her IDA]."

The realization that participants could save regardless of their limited income is especially pronounced among sporadic savers, since none of them made consumption changes in order to deposit money into their IDAs. However, thirteen out of fifteen consistent savers changed their consumption patterns to deposit money into their IDAs and currently sustain those changes.[4] Data from the interviews suggest that this change in consumption pattern allows those savers to save consistently and plan for future asset development.

Consistent savers not only realized that they could save within their limited means, but also that they could and should change their consumption patterns to ensure the development of a sustained saving pattern. In essence, consistent savers learned new patterns from the restrictions on withdrawals and the financial literacy classes.

Our findings support work by Clancy, Grinstein-Weiss, and Schreiner (2002) which found that financial trainings have substantial effects on lower-income individuals. Twenty-six out of the thirty interviewees found the financial literacy workshops helpful and continue to apply the skills. Out of the four people who did not find them useful, two stated that they knew all "most of the stuff" prior to opening their IDAs, one stated that they did not seem "too serious," and the last said she did not remember much. However, all of the savers found the workshops useful and continue to apply the skills today.[5]

Financial Management Training

The consistent savers were able to note specific elements of the workshops that have had lasting impacts on their lives. One interviewee said a session about different savings tools and compounding interest changed his perception of saving and investing money. The other "take-aways" were budgeting, "strategies and attitudes" needed for saving, credit counseling, home ownership strategies, and tax laws. The financial education component of EARN's program was an

[4] Of the two who didn't, one woman was already saving, so she diverted money from her personal savings account, into the IDA. Another man got a raise, so had extra income available to save without making any spending changes.

[5] One non-saver noted that she found the workshops "very informative" and hopes to apply the new skills when she graduates from college and finds a job.

especially important factor because many of the interviewees entered the program with very limited financial literacy. They did not consider saving because they did not know how to. One interviewee explained that the educational component was very important because "once you start finding out how to do things, you get excited…at one point, I wasn't saving anything, but something that I thought was impossible, was actually very doable."

Personal Efficacy

There are other differences between the consistent savers and non-savers that are not directly related to EARN's program structure.

The differences point to changes in personal preferences and characteristics. First of all, every consistent saver has higher self-esteem and feels more empowered to make other life choices since finishing the program.[6] The same alumni explained that setting a savings goal, then reaching that goal, demonstrated the value of goal-setting. They continue to set personal and financial goals: "Finishing the IDA was a really big confidence booster… to set a goal and reach that goal. Since then, I've been able to use that pattern in other aspects of my life."

The shift in self-perception is an important factor in sustaining saving because the savers feel that they are developing future wealth. Saving money becomes a means to an end (more assets) as opposed to a simple end (emergency fund) for those who continue to save.

[6] However, it's important to note that 2 of the consistent savers said other aspects of their lives (finishing graduate school and their age) have had a greater impact on their self-esteem. Only one out of five non-savers has higher self-esteem and feels more empowered because she finished the program — she is currently enrolled in college.

Orientation Toward Future Goals

Another characteristic of consistent savers is a shift towards future orientation. Consistent savers are planning to acquire more assets (education, home, or small business) and consistent savers with a small business have plans to expand their businesses. Savers in general feel that they have more control over their future finances and their plans for their financial future. One interviewee who recently lost her home explained that even though she lost her house and has bad credit, she feels more confident about asset growth and wealth for her future. She is currently saving for her daughter's college fund. Overall, consistent and sporadic savers display more indicators for future wealth development. They are more likely to have IRAs and/or 401ks, to reinvest their savings in their microenterprise, and to save for their children's education. They are also more likely to discuss financial management issues with their family members.

Overall, there were noticeable shifts in economic behavior for participants. We believe that the changes described above will lead to sustained asset accumulation.

SOCIAL EFFECTS

Relationships with nonprofit organizations

Participating in EARN's IDA program also affected alumni's perceptions of social support and nonprofit organizations. This is an important shift because they are more likely to connect with a wide range of non-profit organizations as they build their assets. Before entering the program, four of them were skeptical of the IDA program and other social support organizations; but after experience with the EARN IDA program, they are now excited about their success and they continue to access other nonprofits. They have developed a new trust for nonprofits in general and IDA programs in particular.

An important element in this transition was the positive relationships the interviewees developed with EARN staff, and the trust they developed with the organization in general. Everyone spoke very highly of EARN staff members and noted their professionalism (e.g. phone calls and e-mails returned promptly), understanding of the borrowers socioeconomic situations (e.g. flexibility with deposits and need for translation), and clear communication of protocols and expectations. Several of the alumni entered the program with low expectations of nonprofits and financial organizations, but left the program with a new set of norms for interacting with such organizations; they have extremely high expectations and now seek out services.

Social networks

Participating in the IDA program also motivated some individuals to recognize incompatible social networks and seek out more relevant networks — they actively renegotiated social connections. Some of the interviewees explicitly acknowledged shifts in their social interactions. Five interviewees have changed friend groups and have "let go" of friends who do not share their spending habits, financial and social lifestyles, and personal goals. One person stopped associating with, and lending money to, her friends whom she deemed "irresponsible."

Another interviewee explained: "I look more closely at people and how people are. I look at people who make big purchases that are really lavish… but I wonder if they have savings. Before, I would feel some kind of pressure for competing for trendy things with friends, but now I have more security and something going for me inside… I think I took a step up from before. I stopped going out with those people who's [sic] always spending a lot of money. I changed friends."

Civic Engagement

We also see a trend towards increased civic engagement among EARN savers in this study.

Several of the alumni are resources for other friends and community members who want more information about financial services and resources.[7] Twenty of the interviewees are more active in the communities since finishing the program. They participate in church, school, and neighborhood associations. Several of the current savers also mentor and tutor students, and volunteer through their children's school.

CONCLUSIONS

First, the findings suggest that enrollment in IDAs can lead to a sustained pattern of saving. An important component of success in this arena is the shift in self perception about the ability to save on a limited income, suggesting that financial management training within the context of a savings program can yield enduring behavioral changes. Second, the integrity of the program and program staff matters. IDA participants are all low-income individuals who have had limited interactions with financial development and wealth-building programs. Several interviewees were even initially skeptical of a financial program that offers high returns on investment. If IDA programs want to foster widespread behavioral and economic change, they must serve as responsible and able introductions into the financial world for many of the participants. In other words, IDAs must be able to help participants

[7] Six people stated that they go beyond referring others to EARN — they share information about interest rates, saving, opening up a small business, etc.

trust formal financial institutions, nonprofits, and social service programs if the goal is to create economically and socially secure individuals. Third, there are cases where successful IDA participants are willing to renegotiate social connections to ensure financial success. Participants build social capital not only through civic engagement, but also by ending some relationships and developing others that suit their goals. These positive externalities are often overlooked in evaluating the outcomes of IDAs, and will be studied further as EARN deepens our research on long term attitudes toward savings.

ABOUT THE AUTHORS

Leena Im is currently a Fulbright Scholar in Indonesia, where she is studying the impact of the 1998 Asian Financial Crisis on the restructuring of the country's education policy. Prior to her current position, she worked with the Ford Foundation and delivered a ground-breaking research study on new frameworks for guiding quality accountability structures for secondary schools in the United States Leena has also performed policy analysis and strategy development for the public and private sectors, taught undergraduate economics at the University of California, Berkeley, and served as a Teach For America corps member in East San Jose where she taught special education. She received her B.A. in Political Science and Masters in Public Policy from the University of California, Berkeley.

Camille M. Busette, PhD is EARN's Vice President and Policy Director. She previously served as PayPal's Deputy Director of Government Relations where she managed advocacy efforts for the Americas. In addition to state and federal legislative advocacy, she worked closely with several national central banks and U.S. federal regulators on financial services issues. Prior to joining PayPal, she headed the privacy function at Intuit, and the consumer and market research division at NextCard. Dr. Busette is a former Ford Foundation Post-doctoral Research Fellow, and holds a PhD in Political Science from the University of Chicago.

ABOUT EARN

EARN, the nation's leading provider of microsavings, is an award-winning California non-profit that gives low-income workers the power to create economic prosperity for generations to come. Since 2001, EARN has helped tens of thousands of low-wage families through innovative financial products including matched savings accounts, checking accounts for the unbanked, micro-loans, and money management coaching. EARN's powerful combination of lasting assets and financial know-how enables families to build wealth and achieve life-changing goals such as saving for college, purchasing first homes, or starting small businesses.

The EARN Research Institute evaluates the impact of EARN's work and publishes original data, sharing lessons learned and best practices. EARN uses this unique grounding in rigorous research and direct service experience to transform the financial services landscape and to champion effective public policies. EARN's ultimate vision is that millions of well-informed, low-income American families will achieve financial success through proven strategies, fair public policy, and their own hard work.

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FOR FURTHER INFORMATION

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