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Investment Patterns and Financial Choices of Daily Wage Earners; A Theoretical Perspective

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Abstract
The daily wage earners make a significant proportion of the workforce in developing economies, but investment behaviour of these people is not analysed in a comprehensible manner. The present theoretical paper is to establish a conceptual framework to explain how people with irregular income, small and unprotected invest. Based on the economics of poverty and behavioural finance and financial inclusion literature, it posits that the investment pattern of daily wage earners is rational and a behaviourally driven response to three structural constraints: income volatility, thin surplus and limited trust in formal institutions. The constraints give rise to four behavioral reactions (liquidity preference, mental accounting, present bias on demand for commitment, and dependence on social networks), result in a distinct portfolio of cash, gold, chit funds and savings groups, and informal credit relationships, and limited formal products. It contrasts the dominant tools and argues that formal inclusion is more unlikely to lead to investment than to create an account for a household, and suggests viable propositions for testing. It finds that policy should make products based on cash-flow reality and commitment needs, not just on financial literacy to influence behaviour.

Keywords: daily wage earners; investment behaviour; informal sector; financial inclusion; behavioural finance; household savings

1. Introduction

An unskilled worker on a daily wage is a person receiving wages purely on a daily or task basis, and who is not contracted, has no fixed salary, does not receive paid leave or employer-provided social protection. This includes construction labourers, loaders, farm workers, head load workers and a large proportion of domestic and street workers. Casual wage labour in India makes up about one-fifth of the employed population (National Statistical Office, 2023) and this is the case for other developing economies as well. The decisions they make about finance, as such, are thus relevant to household welfare, the design of financial inclusion programmes and the stability of local economies.

It's strange to talk about the investment strategy of individuals who frequently are struggling to make ends meet after paying for food, rent, and health-care expenses. However, from financial diaries from Bangladesh, India and South Africa, it is clear that many low-income households have portfolios of saving and lending, and in some years use an exceptional range of instruments (Collins et al., 2018). They save for smooth consumption, for irregular expenses including wedding and sickness, and to build up small assets. The broad definition of investment is taken here: anything that involves spending current income

in order to receive a benefit from it at a later date, whether monetary or physical, or whether in the form of informal savings or investment in health, children, and livelihoods.

The mainstream portfolio theory is of limited assistance. It takes as given that income is stable, there are diversified markets, reliable information, and demand for expected returns. No worker who is not certain about tomorrow's employment fits any of these situations. This article thus poses three questions. What are the limits on daily wage earners' investment decisions? What are the processes of behaviour that help these constraints become a recognisable pattern? What then for financial inclusion and policy? Its contribution is a framework, a comparison of instruments and a set of propositions for empirical testing.

2. The Economic Lives of Daily Wage Earners

2.1. Income volatility and thin surplus

The most distinctive employment category is that of daily wage workers, for whom income is unpredictable, in terms of both quantity and schedule. A week of rain, a contractor's slip-up or illness can wipe out all the income. Empirical studies of the lives of the poor suggest that low-income families have multiple sources of income and tend to be self-employed, that borrowing can be costly, and that insurance against risk can also be expensive (Banerjee & Duflo, 2007). There is not a lot of surplus to invest in any one period, and it has to compete with pressing needs.

In the face of income uncertainty, standard consumption theory suggests that households will build up buffer stocks, with saving in good years and higher spending in bad years, in order to buffer themselves against large declines in their incomes. (Deaton, 1989) However, the buffer is difficult for wage earners who earn low and irregular incomes to establish and maintain. This leads to small, short-term, and frequent saving, and to the first use of the asset being "shock absorber" rather than "return."

2.2. The cognitive burden of scarcity

Scarcity even influences people's decisions. People who focus on money issues have less mental energy to devote to considering options and evaluating their consequences (Mullainathan & Shafir, 2013). Experimental studies were conducted in India and the United States that demonstrated that the financial burden lowered performance on cognitive tasks among individuals earning low incomes, but not among those earning higher incomes (Mani et al., 2013). A behavioural approach to poverty can point to some fundamental errors (for example, not having a long-term plan), which may be due to the price of constant juggling, rather than lack of knowledge (Bertrand et al., 2004). It's a policy interpretation because it suggests that simplifying choice rather than increasing information can be beneficial.

3. Behavioural Mechanisms

Figure 1 summarises the conceptual framework. Structural constraints generate behavioural responses, and these jointly produce the observed investment pattern. Four responses are especially important.

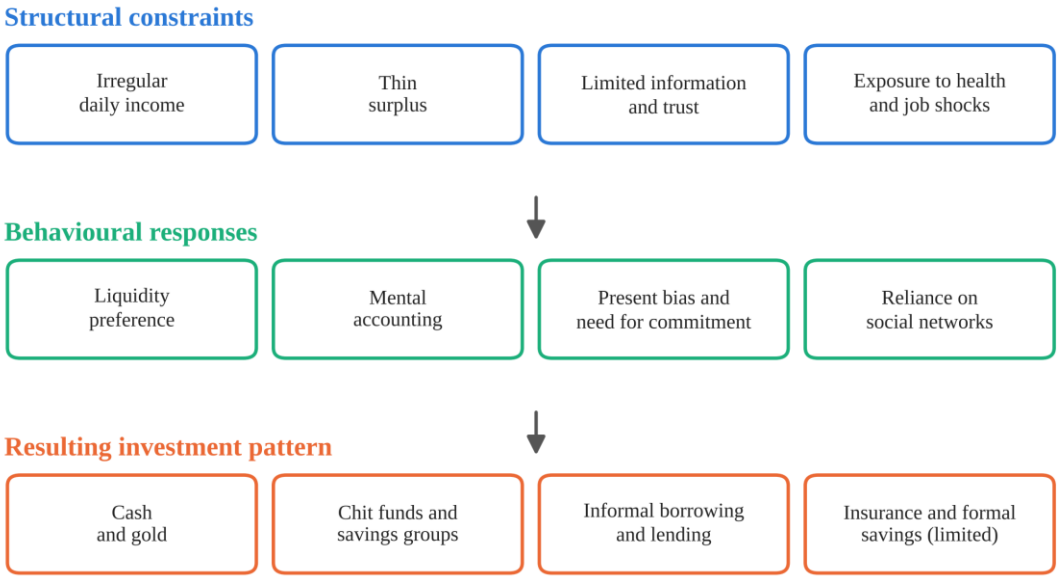


Figure 1. Conceptual framework: constraints, behavioural responses and the resulting investment pattern of daily wage earners (author's synthesis).

3.1. Liquidity preference

When there is no regular income and lots of emergencies, the ability to turn assets into cash rapidly is more useful than the higher rate of return that is tied up. It is therefore not surprising that the market is dominated by cash and gold, due to liquidity preference. It also provides an explanation of why early withdrawal penalties are a drawback even if interest rates are high. This measure of return for these households will not be the annual percentage yield, but the chance of having money available on the day one needed it.

3.2. Mental accounting

Individuals often assign distinct mental rules to their various mental accounts, and don't view all money the same way as fungible (Thaler & Shefrin, 1981). A person who earns a living on a daily basis can act as if money in his pocket is spendable, chit contribution is committed and gold is untouchable, unless in a crisis. This labelling helps to prevent impulse from harming savings. Simple tools that resulted in a visible, marked space for health funds, like a protected box or a rotating group, led to higher investments in preventive health products in Kenya (DuPAS & Robinson, 2013).

3.3. Present bias and commitment

Prospect theory is a model of how people process gains and losses from a reference point, and how they tend to overestimate the value of near-term gains (Kahneman & Tversky, 2013). In saving, it becomes what is termed present bias, the desire to save for the future is overcome by the desire to spend the money today. In the Philippines, a commitment savings account (CSA) that made it difficult for people to make deposits until a savings objective was met increased saving rates for people with present-biased preferences (Ashraf et al., 2006). Within another domain, small time-limited discounts led to more use of fertiliser among otherwise postponed-purchasing farmers (Duflo et al., 2011). The universal theme is that individuals with a small savings surplus are interested in external arrangements that automatically save.

3.4. Reliance on social networks

Social ties take the place of formal contracts where they don't exist or where they're not trusted. Households provide loans to neighbours, participate in rotating savings associations and obtain advances from employers or relatives. The arrangement can be described as an informal insurance since the provision of aid today gives rise to a claim for aid the following day (Collins et al., 2018). They also charge fees: network members may ask for shares of savings and not being able to refuse can reduce the surplus a household attempts to increase.

4. The Resulting Investment Pattern

Constraints and behavioural responses give a characteristic portfolio together: this is compared in Table 1. It can be said to be a layered pattern. Cash and mobile balances address needs as they are required and needed. The gold or other physical assets are used as a medium-term store of value and as collateral. Chit funds and savings groups are used for discipline for bigger aims. Informal credit and reciprocity insurance. Formal accounts, insurance and pension products are a small but increasing portion of the portfolio, if present at all, and are considered to be marginal.

Table 1. Typical instruments in the portfolio of daily wage earners

Instrument	Liquidity	Main role in the household portfolio	Principal weakness
Cash at home	Very high	Absorbs daily shocks and small purchases	Easily spent; exposed to theft and social claims
Gold and jewellery	Moderate	Store of value; emergency collateral	Price risk; pawn costs; sale discounts
Chit funds and savings groups	Low to moderate	Commitment device for lump-sum goals	Default risk; weak regulation
Informal lending and borrowing	Varies	Insurance through reciprocity	High interest; dependence on networks
Formal savings account	High	Safe storage; receipt of transfers	Dormancy; transaction and access costs
Insurance and pension	Low	Protection against large shocks	Low trust; premium timing mismatch

These forces are evident in many homes across South Asia, with many belonging to those who love gold and consider it to be their biggest fortune. Gold can be carried, divided into smaller portions, is recognized for its cultural value and easily accepted as a unit of credit, therefore fulfills the function of a store of value, simultaneously being both liquid and not subject to daily use. Its drawbacks are also evident: volatile prices, making charges and the discount suffered when selling quickly. In the framework, gold is not a symbol of financial backwardness or an ideal investment, but rather, a logical choice between liquidity and commitment, especially when formal investment options are absent.

This portfolio has three things that should be highlighted. The first is that it is diversified over instruments, but not over risks: generally, all assets are subject to the same shocks as the income of the worker. Secondly, it is a saving and borrowing in one go, since households may have savings and informal borrowing simultaneously; a combination that seems irrational, unless one understands that savings are

kept as a precautionary measure and loans as an obligation. Third, the investment in human capital, which is often more important than financial returns, as in the case of the education and health of children, is often neglected by conventional measures of investment (Banerjee & Duflo, 2007).

5. Financial Inclusion and the Gap between Access and Use

In developing economies, the number of accounts has increased quickly, aided by digital payments and transfers from the state. However, the survey results globally provide evidence that non-use of accounts has not necessarily led to inactive saving; and that there are currently inactive accounts in some major economies, including India, in several of these (Demirgüç-Kunt et al., 2022). If a wage earner accepts a transfer into an account, but empties it at once, that account acts as a conduit and isn't considered an investment.

India and Indonesia provide instruction. Financial education was not found to have a significant impact on account uptake among unbanked households, but a small financial incentive did have a significant impact, according to Cole et al. (2011). This indicates the value of price, convenience and trust to knowledge. Concurrently, there is a positive cross-country correlation between financial literacy and wealth accumulation and wealth planning (Lusardi & Mitchell, 2014), meaning that financial education and product design complement each other.

Well-designed access can be seen in the digital finance. For instance, in Kenya, households that were mobile money users were better able to sustain their consumption during shocks because they have access to remittances from their mobile money networks which are faster and cheaper (Jack & Suri, 2014). Evidence from the longer-run period suggests that mobile money had a positive impact on per capita consumption and helped shift a proportion of households away from poverty, more so for female-headed households (Suri & Jack, 2016). The findings reveal that products with similar logic (liquidity and network dependence) can be taken up and can provide tangible benefits.

6. Discussion and Propositions

The concept in the framework is that the investment style of daily wage earners should not be compared with that of a salaried investor. A household that saves some of their money in gold, participates in their chit fund and holds informal obligations may be reacting sensibly to the volatility of their income and weak institutions. The question that needs to be asked is not why wage earners don't purchase mutual funds, but what about the formal product makes it so at the point of sale? Research reviews have confirmed that, among the poor, product characteristics like commitment, reminders and flexibility in the size of deposits tend to be more important than the interest rate (Karlan et al., 2014).

Here are a few suggestions for empirical testing. P1: Lives with higher income volatility have more liquid assets and less locked in instruments in their household portfolio. P2: commitment characteristics increase savings of present-biased households more than those of others. P3: low cost, rapid transfer of digital channels lessens dependence on high interest, informal credit after shocks. P4: Learning about financial education with the clear addition of an incentive or a simplified product increases the formal uptake of financial education more than financial education alone. P5: The partial withdrawal is allowed without any penalty to the formal products and they are more likely to be used for investment rather than rigid

products. The propositions can be tested with the household panel data, financial diaries and randomised trials.

There should be a focus on gender and intra-household dynamics. Women's savings might be more susceptible to claims by family members, and commitment devices can provide them with a legitimate excuse for rejecting such claims (Ashraf et al., 2006). Meanwhile, results from the mobile money indicate that private and convenient channels can enhance the outcome of female headed households (Suri & Jack, 2016). Gender-specific investment patterns should thus be disaggregated by gender and by who takes the decision on investments, not assuming that the investment decision is made by the household as a whole.

7. Policy and practice implications

The question for the policymaker is how to design products that are based on cash flows. Flexible micro-sized deposits, partial withdrawals and reminder or automatic contributions are better suited for the needs of people with day-to-day incomes than fixed monthly payments from a savings scheme. Insurance should be collected in small increments and be paid out promptly, or the trust is lost. Agent networks and mobile channels do offer financial institutions potential savings in transaction costs, if they are reliable and transparent. For employers and contractors, who may be involved in wage payments, making payments to accounts and enabling savings may help. In the civil society arena, these trusted middlemen like the savings groups can connect informal and formal systems, as long as they are not exposed to fraud.

8. Limitations

This article is a conceptual synthesis, it does not include new primary data. A significant amount of the evidence presented is from experiments conducted in Kenya, the Philippines and elsewhere, and this could not necessarily be replicated in all contexts. There is also a high degree of diversity among daily wage earners in terms of their choices as a result of gender, migration, sector and local institutions. Future studies should consequently merge data from the household level of specific occupations with a qualitative study of household decision-making processes.

9. Conclusion

Daily wage earners' investment behavior is an adaptation to unpredictable earnings and underdeveloped institutions that is logical given behavior. The dominance of cash, gold, chit funds and informal obligations and the low level of account usage of the latter can be attributed to the phenomenon of liquidity preference, mental accounting, and present bias and the use of social networks. The policy lesson is that inclusion should be judged by the extent of usage not the number of accounts. Products that work with the flow of earnings, allow flexibility in how they're used, and are reliable and trusted are more likely to become an investment rather than a safety net.

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