MOBILIZING SAVINGS

KEY ISSUES AND GOOD PRACTICES IN SAVINGS PROMOTION

DEZA DIREKTION FÜR ENTWICKLUNG UND ZUSAMMENARBEIT
DDC DIRECTION DU DÉVELOPPEMENT ET DE LA COOPÉRATION
DSC DIREZIONE DELLO SVILUPPO E DELLA COOPERAZIONE
SDC SWISS AGENCY FOR DEVELOPMENT AND COOPERATION
COSUDE AGENCIA SUIZA PARA EL DESARROLLO Y LA COOPERACIÓN

MOBILIZING SAVINGS

KEY ISSUES AND GOOD PRACTICES IN SAVINGS PROMOTION

Published by: Swiss Agency for Development and Cooperation, © SDC, February 2004
Author: Isabel Dauner Gardiol, Intercooperation, Bern
Images: Toni Linder, SDC
This brochure is available in English, French and Spanish. Additional copies can be ordered from: e-i@deza.admin.ch

Table of content

Boxes:

Mobilizing Savings

Key issues and good practices in savings promotion

Even poorest households want to save and do save, be it in kind or in cash, to overcome difficult periods. They save in financial institutions if they have access to those institutions and if they trust in them. For many years, the microfinance industry has emphasized credit services as the most important financial service to poor households. Today we know that credit together with savings and other well tailored financial services (insurance, money transfers, etc.) are important instruments for poverty reduction and empowering poor people, especially women.

The Swiss Agency for Development and Cooperation (SDC) in its Policy for Financial Sector Development[1] stresses the strategic importance of savings for development, in that savings promote the autonomy of individuals, households and enterprises as well as of financial institutions and the national economy.

The present publication provides an overview of the needs and demands of low income households for savings services (micro level), as well as of savings mobilization from the perspective of a financial institution (meso level) and the regulatory financial authorities in developing and transition countries (macro level). It is conceived as a tool for SDC collaborators and partners as well as for all other person involved in the promotion of savings services by financial institutions.

Much has been written on savings in the context of microfinance. We have utilized some of this documentation, as well as case studies from SDC partners around the world. References to key research and case studies are provided at the end of each chapter for those who wish to further examine specific information.

The first chapter, "**Why and how do poor households save**?", offers an overview of low income households' monetary and in kind saving habits, investment decisions and liquidity management. It emphasizes the diversity of households with respect to motives and forms of savings.

Chapter 2, "**Mobilizing monetary savings from low income households: The institutional perspective**", summarizes potentials and risks for the institution providing savings services to its clients and members. It is necessary for the institution to fulfill a certain number of prerequisites before entering into savings mobilization in order to ensure the success of that venture and to avoid losses to poor clients..

In chapter 3, "**Product development, diversification and innovation**", the reader will become acquainted with microfinance institutions that already offer savings services in different countries, and get an overview of the broad diversity of possible savings accounts. The chapter

[1] SDC (1998), SDC Policy for Financial Sector Development, Berne.

enhances the need to analyze the potential demand and the existing offer from competitors before designing and implementing the new service. Proceeding in a cautious, professional and informed way will increase the chances of success.

The last chapter, "**Legal and economic framework for savings mobilization**", presents important aspects related to macroeconomic conditions and the regulatory framework in which savings mobilization takes place. Some key questions should be asked before designing a regulatory framework that allows microfinance institutions to mobilize voluntary savings from their clients. Are there macroeconomic situations where saving mobilization should not be promoted? Which legal and regulatory framework is adapted to the microfinance sector of the country ? What alternatives are available to protect clients' savings?

This publication has been developed by Intercooperation, Bern, on behalf of SDC. It benefited from highly appreciated contributions of SDC collaborators and partners of all over the world. We hope that this document will provide a useful basis for the promotion of savings services and contribute to the development of inclusive financial sectors.

Bern, February 2004

Swiss Agency for Development and Cooperation
Employment and Income Division

1. Why and how do poor households save?

1.1 Introduction

“The poor households want to save, and do save…but it is not easy”.[1] Households need to save money in order to reduce their vulnerability to negative shocks, such as natural disasters, crop failures, job losses, illness or death in the family. With savings, in kind or in cash, a safety net is created. In a longer-term perspective, savings can contribute to increase the income base, for example by investing in the children’s school education, buying a cow, or perhaps a new sewing machine. More stable households may invest in land or other productive assets.

If we would use a narrow definition of savings -the action of accumulating money in order to ensure a comfortable life after retirement- we would conclude that poor households can’t save. But if we take a broader definition -savings as a means to secure future consumption at any time- poor households do save.

We will now address the following questions:

1. What is saving from the point of view of poor households?
2. Why do poor households save?
3. How do they save?

[1] Rutherford (2000).

1.2 What is saving?

Saving defines the action of **putting aside a part of current income**, in order to consume or invest it later on. The money saved can be either kept at home, deposited in a savings account or invested in different types of capital. Because many low-income households in developing countries have a small informal family business or a farm, they invest part of their savings in the production unit, in order to increase future income.

Saving in monetary form is just one way to **manage the liquidity** of the household. If credit is available, it is also used for liquidity management. The actions of saving, dissaving (consuming more than its current income), lending and borrowing money interact constantly. Experience shows that households do save more often than they borrow money.

Throughout this note, we will refer to the following **definitions**: Saving is the action of keeping part of current income to use it later.[2] Savings defines the amount kept aside in the current period (income minus consumption in a given period).

1.3 Why do poor households save?

Studies on the saving behaviour of poor households in Asia, Africa and Latin America (few have been written yet on poor households’ savings in Eastern

[2] In economic theory, the current period refers to the current year and the future to all years thereafter.

Europe) all agree upon the different motives of saving. What differs are the approaches and terminologies. We present the four motives which are cited most often:

- **Decrease their vulnerability**

- The poor constantly live with uncertainty regarding their capacity to cover their family's basic consumption needs. By saving, they insure themselves against bad times, and try to avoid having to cut their consumption expenses.
- In that sense, savings can be seen as an insurance. Households save for emergency cases (bad harvest, sickness, job loss), because in most cases they do not have access to or cannot afford formal insurance services.
- Saving also allows households to equilibrate uneven cashflows between different periods of the year (see examples in box 1).

- **Accumulate lump sums**

By periodically saving small amounts of money, households can accumulate lump sums for the following purposes:

- To have money to cover expenses related to **life-cycle needs** (marry a daughter, which might be very expensive in India, or bury a parent, which is expensive in Africa).[3]
- To pay the school fees of their children at the beginning of the school year or send a child to a higher education institution, in order to increase their **human capital**.
- To buy construction material for building a house, or invest in any type of good that strengthens the household economy (a grain silo, a water pump, etc.) and increases their **physical capital**. Households in Mexico, for example, accumulate money to purchase agricultural or other production equipment in quantity in order to get better prices and save on transaction costs.[4]
- To invest in "visible" assets that increase status and recognition in the community. Such cases have been mentioned in West Africa, particularly the Sahel region, where cattle has a high social value[5], or in the valley of Tomina in Bolivia.[6] Indirectly, they invest in their **social capital**, because a higher status provides better access to networks of relation and information. But very often, "visible" assets have also a higher financial return than monetary savings in a financial institution.

- **Bequeath relatives and friends**

- In the slums of New Delhi households who have migrated from their village to the city save some money in order to send it to their relatives who stayed behind.[7]
- To accumulate assets for their children's future. Many rural households in Nicaragua, although not the poorest, buy land in order to hand it over to their sons.[8]
- To have some "disposable" income in order to lend it when a neighbour

[3] ib.idem

[4] Conde Bonfil (2001).
[5] Goldstein and Barro (1999).
[6] Beuret and Beuret (1992).
[7] Ruthven (2001), .
[8] Dauner (1998).

or a relative has an urgent need. This can also be considered as a contribution to social capital.

- **Obtain or repay a credit**

- This motive for saving is often cited in the empirical studies on poor households savings in formal and informal financial institutions.[9] Nevertheless, it is difficult to balance the importance of this motive, given that many financial institutions impose clients to deposit money in an account as a prerequisite to obtain a credit.
- Moreover, it can be related to the wish of accumulating a certain lump sum, in order to make an investment. With a credit, this investment may be possible earlier.

1.4 How do poor households save?

The question of how poor households save is probably the most frequently asked in studies on the subject. First, because it is more obvious and visible than the "Why to save?" and, second, it is more interesting for financial institutions (potential deposit receivers) to know the "how" than the "why". Nonetheless, we have to keep in mind, that both questions are closely related.

An empirical study on West Africa shows how poor women use different savings services for different purposes: 1. they save in decentralized financial systems, in order to obtain a credit; 2. at the deposit collector, in order to manage the liquidity of their economic activity; 3. in tontines, for future consumption, health expenses, housing and economic activity, as well as social relations.[10]

- **In which form do they save?**

- Whenever possible, poor households save **small and variable amounts**, in kind or in cash.
- They have a **diversified portfolio of saving**, ranging from liquid forms (money, gold, jewelry, clothing, etc.), to less liquid forms (housing material, chicken and pigs, cattle, land, etc.). Households in West Africa have explained that they first take hold of their very liquid assets and then of their less liquid ones, because the latter yield higher returns than the former.[11]

- **Where do they save?**

- A household's **home** is probably the most universal place where to keep money, although it is often not very safe, either because temptation to use it is big, or because it might be stolen easily.
- Few poor households deposit money in a **bank savings account**, either because they have no bank close to their home, or because conditions are not adapted to their needs. For example, households in a Delhi squatter settlement found it "…safe rather than convenient" to deposit money in a bank. Nevertheless they did so because the money was kept safe from uncontrolled spending![12] All over the world, poor households deposit money in **Savings and Credit Cooperatives**, if they have access to those facilities.

---

[9] See Rutherford (2000), Goldstein and Barro (1999), Dauner (1998).

[10] Goldstein and Barro (1999).
[11] Ib.idem.
[12] Ruthven (2001).

- Examples from India, Bangladesh, Africa, and to less extent Latin America, show that households dispose of diversified **informal mutual savings systems**: savings clubs, Tontines, ROSCAS, ASCAs, Pasanaku, Munno Mukabi, etc.[13] In these systems, members save regularly small amounts of money in order to accumulate a lump sum for a social event or even as start-up capital for a business. It also may be very important for them to participate in such systems in order to increase their social relations.
- Those who do not have any secure place to deposit their savings entrust it to a **money guard**, who can be a neighbour, a relative, one's employer, etc. In some places, particularly where money rotates frequently (on markets, bus central stations, etc.), professional **deposit collectors** visit people every day and, for a fee, collect savings from persons who wish for such a service. In a Delhi slum, households have also said that they may deposit money at a goldsmith's, who keeps it for them until needed.
- **Reciprocal lending** (i.e. lending between relatives, friends or neighbours) is also used as a means of saving. It probably yields higher returns than depositing money, and often serves a social purpose, but might not always be very secure.

➢ **How often do they save?**

- The above examples show that low-income households save **very frequently**, according to their income flow. For example, women, who sell vegetables every day on the market, save each time they can. Farm households, on the other hand, do not save frequently, if their income depends only on agricultural production.

1.5 Conclusions

- Low income households save in various forms, for reasons and purposes specific to their needs and entrust their monetary savings to different persons or places (neighbour, financial institution, under the mattress, etc.).
- Saving has both short and long term objectives. In an immediate sense, this small security can help a family to maintain some balance during periods of income shortfalls. In the long term, savings allow response to life cycle needs or to investments in physical, human and social capital. Savings represent a safety net against negative shocks, which threaten the survival of the household, and help to decrease the vulnerability of the poor. In that sense, savings replace missing, or deficient, health and employment insurances.
- Depositing money in informal savings associations or clubs also serves a social purpose. Households can increase their social capital, by participating in a community action.

[13] Rutherford (2000) provides detailed explanations on the functioning of those systems.

- The security, the liquidity and the accessibility of monetary savings[14] are the determinant criteria to decide where and how to save, especially by poor persons who cannot afford risk.
- The returns and value of monetary savings are secondary determinants. They become important when people start to invest for the long run.
- Depending on the cultural context, discretion might be an important issue, when people chose where to save. In some cultures, people like to show what they have because it increases their social status. In others, people prefer to hide it.
- Saving in a financial institution or an informal system might create a certain discipline. It helps people to better manage their liquidities.

[14] See chapter 2.

1.6 More information and links

Suggested readings:

Rutherford S. (2000), *The Poor and Their Money*. Oxford University Press, New Dehli, India.

Mutesasira L. (1999), *Savings and Needs: An Infinite Variety*. MicroSave-Africa, Kampala, Uganda.

Websites with downloadable publications:

MicroSave Africa: www.microsave-africa.com

Money Matters: www.idpm.man.ac.uk/idpm

Other references:

- Conde Bonfil C. (2001), *Depósitos o puerquitos ? Las decisiones de ahorro en México*. El Colegio Mexiquense, Unión de Esfuerzos para el Campo – La Colmena Milenaria, México.
- Dauner Isabel (1998), *Demanda de servicios de ahorro en las zonas de incidencia del Fondo de Desarrollo Local*. Nitlapán-UCA, Nicaragua. Mimeo.
- Goldstein G., Barro I. (1999), *Etude sur le rôle et l'impact des services et produits d'épargne du secteur informel et des institutions de microfinance en Afrique de l'Ouest* PNUD-FENU, Special Unit for Microfinance (SUM), MicroSave-Africa. Mimeo.
- Beuret S., Beuret J.-E. (1992), "L'épargne dans l'économie paysanne de Tomina". *Les cahiers de la Recherche Développement* no. 34, Paris, France.
- Ruthven O. (2001), "Money Mosaics: Financial Choice and Strategy in a West Delhi Squatter Settlement". *Working Papers Series no. 32*, Nov. 2001. Finance and Development Research Programme, University of Manchester.

Box 1

Saving money for contingencies and for future investments

- Two examples from Indian women –

1. Bheemamma –a vegetable vendor

Doma Bheemamma, resident of TD Gutta Of Mahabubnagar, has been doing the vegetable vending business in the market since 20 years. Three of her family members are doing the same business. Her elder son buys the vegetables from Shamshabad and Hyderabad, and the younger son sits in the wholesale shop in the same market. She herself sits in the same marke, independently, and does retailing of leafy vegetables, lemon etc. Her daughter in law, named Laxmamma, also does the same retail vending besides her. The family is big and joint, every one performs their role well and does their business independently and even the decision on their earnings are made independently. At the age of 50, Doma does retail sales actively with good customer base. When the KBS bank (Krishna Bhima Samruddhi Local Area Bank) approached her and introduced about the daily deposit product she immediately became an account holder by saving Rs.10 per day out of the daylong earnings. She wants to save for the contingencies. Doma says that she will go on saving because it makes her feel secure in front of any adverse situations like old age, health and disasters.

The case reflects that women can do business and support their family. In spite of many of her earning family members who are young she does not want to sit idle, she still wants to continue to do the business and also wants to save to fulfill her needs by her own till she has strength to work.

2. Mrs. Laxmidevi- woman entrepreneur

Mrs. Laxmidevi, a house wife resident of Nadigama village of Mahabubnagar district, came to Mahabubnagar seven years back along with her husband and children (as they found agriculture is not remunerative), with an intention to start some business in Mahabubnagar and to give good education to their children. Her husband started a small stall of bakery items. The income was not sufficient to fulfill their family needs hence she purchased a sewing machine and started taking stitching orders from nearby households. After two years she found the demand was more, hence, she purchased two more machines and started training the other women in sewing and started to take orders and pay the other two women workers on piece work basis. Then she has taken on rent a front side shop attached to her house. As the customer base increased, she started diversifying the activity, slowly turned into sales of falls, blouse, material, saris, etc. She borrowed some money for buying the machinery and after paying back her credit, she again borrowed and bought cloth material. After hearing about the KBS banks new product of daily deposit, she found it simple and felt happy and started saving Rs. 20 per day. She also encouraged other workers in the shop to start saving. When she was informed that her savings were 1500/-, she felt very happy and told that it was appearing like she had just started saving the day before. Presently her two daughters are studying in ten plus two standard and the younger son in 6th standard.

Cases of Samruddhi Daily Depositor, provided by:
Krishna Bhima Samruddhi Local Area Bank Limited
1-10-87-5/D, B.K Reddy Complex, New Town, Mahabubnagar

2. Mobilizing monetary savings from low income households: The institutional perspective

2.1 Introduction

Microfinance practitioners all agree upon the fact that even the poorest households can and do save in financial institutions if they have access to those institutions. Moreover, experience shows that those Microfinance Institutions (MFIs)[15] which take in deposits often have more savings than loans, both in number of accounts and volume of deposits and loans.[16] In many countries, MFIs are not allowed to mobilize savings, if they are not licensed as a financial institution and supervised by the responsible authorities. Donors should try to support reforms in legal and regulatory frameworks for MFIs whenever possible, in order to promote the introduction of savings services for the poor. It is also essential to analyze the evolution of macroeconomic and social indicators of a country or region.

In this note, we briefly review the prerequisites that a financial institution should fulfil before starting to offer savings services to low-income households in order to ensure success. We will also briefly present the comparative advantage for the MFI being funded by savings, as opposed to other sources of funding. Finally, we show the positive and negative implications that the introduction of savings services can have for the institution.

2.2 Requisites and success factors for the institution

Level of formality

Before an MFI starts to offer savings services, legal guidelines should be observed. Forced deposits, which are used as a collateral for credits, are generally tolerated by the authorities, given that clients owe more to the institution than the inverse. Those MFIs which are authorized to mobilize voluntary savings have either the legal form of savings and credit cooperatives or of "minibanks"[17]. If they are not willing or ready to adopt either of these legal forms, the institution can rely on linking mechanisms, in order to facilitate their

[15] We classify under MFI those institutions (cooperatives, NGOs, minibanks, village banks, etc.), which offer savings, credit and other financial services to low-income households, who are usually excluded from financial markets.

[16] For example, Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand, Bank Rakyat Indonesia (BRI), Rural Bank of Panabo (RBP) in the Philippines, Fédération des Caisses d'Epargne et de Crédit Agricole Mutuel (FECECAM) in Benin, Centenary Rural Development Bank (CERUDEB) in Uganda, Banco Caja Social (BCS) in Colombia.

[17] Share holding companies which offer financial services, but which cannot be defined as commercial banks as they are limited to certain services.

clients' access to savings services (see examples in boxes 2 and 3).

Strong management and financial viability

Strong management and governance are key requisites when dealing with savings from clients. The microfinance institution must have the financial resources and the know-how to manage a higher volume of less predictable transactions. Clear ownership and transparency allow better control from the clients and increase their confidence. The institution should be financially solvent and show a high level of loan recovery. Potential depositors will feel more secure if they know that the portfolio of the institution is diversified and of good quality. The managers of the institution should follow the evolution of macroeconomic indicators and be able to analyze them.

Image and accessibility

The financial institution must show an image of safety and accessibility if it wants to take in savings from low-income households. Either the money is kept in a safe box and a secure looking building, or it can be deposited in a local bank agency. It is crucial that the institution is easily accessible to the depositors with respect to hours of operation and location. Opening hours should be adapted to the local clients' habits, for example on market days, or perhaps the late afternoon. In very remote areas, the institution can install mobile units in order to collect savings. Customers should be able to deposit money as often as possible as well as feel secure with the staff of the institution. Hence, the staff should be very professional and well-trained in the provision of savings services of this kind

Internal and external controls

Usually, financial institutions that want to take in deposits from clients are submitted to external supervision and regulation by public authorities. Nevertheless, regulators of financial institutions are often reluctant to control deposit-taking MFIs, because these regulators have limited resources to do so and they do not necessarily have a sufficient knowledge of the microfinance sector and its peculiarities. Hence, where external supervision is ineffective or not compulsory, the MFIs should develop efficient internal control mechanisms conducted by an internal control or supervision unit. Internal controls should be combined with the services from an external competent auditor. Moreover, an efficient and adapted MIS (Management Information System) can help detect problems quickly.

Diversified offer

Although an MFI may start offering one particular savings product for a pilot phase, it will bring in higher volumes of deposit when offering a variety of services. It is beneficial to offer a choice of different services, ranging from very liquid products, with a low interest rate, to time deposits with accordingly higher interest rates. Minimum balance requirements must be kept low to attract low income clients. The various uses and needs of savings services by different groups of people should be addressed.[18]

[18] On the diversification of products, see chapter 3.

Sequenced introduction of savings services[19]

It is suggested that an MFI with no experience in voluntary savings services follows a sequenced introduction. First, the institution's board and managers gather information with regard to voluntary savings. Second, the institution carries out a market study and trains staff, in order to introduce a pilot phase. After conducting the pilot phase, an evaluation is done before training more staff, adapting the MIS and expanding the savings services.

2.3 Savings compared to other sources of funds[20]

The structure of funds differs between financial institutions, according to their type. Commercial banks, savings and credit cooperatives, as well as self-reliant village banks generate a large fraction of their funds by mobilizing deposits. On the other end, donor-driven NGO's are mainly funded through grants and soft loans, and less through commercial loans or equity. While grants and soft loans might be an effective way to start operations, they do not form a stable source of funding for the long run. Hence, when institutions grow, they should seek more stable and long term solutions, such as voluntary savings and equity.

Savings can be divided into three types: **compulsory savings**, **voluntary savings** (sight deposits) and **lump sum voluntary deposits** (time deposits). The first category is linked to credit services and used as collateral. Although compulsory savings contribute to educate households in monetary saving, they increase the effective cost of borrowing for the client. Compulsory savings might not be seen as a service per se, but as part of the credit. Thus, it can be difficult for the institution to make the transition to voluntary savings services (Robinson, 1997).

Small voluntary deposits allow the MFI to increase its outreach and depth. Very poor households are best served with accessible, flexible and very liquid savings facilities. Experience shows that in a stable economic and political environment, small voluntary savings can mobilize large and stable amounts of funds for financial institutions. Although an institution's administrative costs to mobilize monetary savings are higher than for any other source of fund, the financial costs of this service are very low. Clients are more interested by aspects like liquidity and security than by the interest rate. Savings clients are also potential borrowers; therefore costs to gather a new customer profile are reduced or eliminated.

Lump sum voluntary deposits (time deposits) can mobilize considerable amounts of money from large individual or institutional depositors. The comparative advantage of this service is its low administrative cost. But on the other hand, financial costs are high because clients who save for longer term and larger amounts also look for a relatively high interest rate. This type of banking is more sensitive to interest rates and more volatile. Moreover, big depositors request complementary services like credit cards, cheques or money transfers, and so, broadening the offer of savings services to

[19] From Robinson (1997).
[20] From CGAP (2002a).

"richer" households will imply relatively high investment costs.[21]

2.4 Consequences for the financial institution

On the positive side, savings mobilization allows the institution to **become more independent** of donor funds. Moreover, clients' feeling of ownership for the institution is increased, which ensures a better control from their part on the management. Because some of the funds handed out as credits come from the community (hot money) rather than from donors or commercial lenders (cold money), the borrowers may be more careful with the money and repayment rates should be kept accordingly high. Savings services considerably reduce the costs for gathering information on clients' payment habits and client scoring.

On the negative side, we have seen above that savings services bear **high administrative costs**, particularly if clients save frequently and in small amounts. Nevertheless, experience from deposit taking MFIs shows that administrative costs of small deposits can be kept low in different ways:[22]

- Savings services should have a simple design and be administered with a computerized system.
- Moreover, the MFI can keep costs low by using lean structures and a small but professional staff.
- Costs and profits should be reported in a transparent way and the performance of the portfolio should be kept high. Staff Incentives can contribute to these goals.
- Outsourcing and networking should be used in order to reduce costs of information and training.
- Economies of scale, i.e. reaching a maximum of clients and offering them both savings and borrowing services, keeps costs low.

For precautionary reasons, regulated financial institutions that take in deposits have to keep minimal reserves, which do not yield any return. In some periods, these institutions might have excess funds from savings that they do not know how to allocate (see box 4 on the Bolivian crisis). They may bear costs to compensate depositors for inflation and may have to build reserves against exchange rate risks. Finally, the **liquidity (asset and liability) management** of the financial institutions becomes much more complicated and costly when savings services are offered. "Effective projections of cash outflows and cash inflows are essential for identifying liquidity gaps in a timely manner and to care for provision-making."[23]

2.5 Conclusions and recommendations

- o For the institution, offering voluntary savings requires prior investments in an efficient management information system (MIS), in transparent internal control mechanisms and in staff training.
- o Savings services should be introduced once the institution has a strong management.
- o The security and accessibility of deposits are key factors to attract low-

[21] For a detailed comparison of different sources of funds, see Wisniwski (1999). On the costing of financial services, see www.microsave-africa.com and enter the keywords "costing and pricing of microfinance".
[22] Robinson (1997).

[23] Wisniwski (1999).

income households to a savings institution.

- Although administrative costs may increase with savings services, the institution will gain more independence from donours in the long run and hence, more stability.
- The introduction of savings services may generate more loyalty between clients sharing a common interest for such services, and thus reduce the risks of delinquency.
- The financial cost of funds may also decrease if the interest rate paid on savings is lower than that of commercial funds.
- Because savings are costly, the institution should start with a test phase and proceed by sequences before offering massive voluntary savings services.
- Donours can have several roles in the promotion of savings services for the poor. First, they can influence the policy dialogue for the elaboration of a legal and regulatory framework adapted to MFIs. Second, they can encourage MFIs to offer savings services by transmitting a clear message on their funding intentions in the long run and/or by relating their amount of funding to the amount of saving.
- Finally, donours can help those microfinance institutions which are transforming themselves into deposit takers. They may fund technical assistance to MFIs in order to introduce and develop new savings services adapted to the needs of the clients.

2.6 More information and links

Suggested reading:

CGAP (2002a), *Developing Deposit Services for the Poor: Preliminary Guidance for Donors*, Washington DC

CGAP (2002b), *Savings are as Important as Credit: Deposit Services for the Poor*, Donor Brief no. 4, June 2002

Websites with downloadable publications:

Consultative Group to Assist the Poor: www.cgap.org

MicroSave Africa: www.microsave-africa.com

FINCA's village bank methodology : www.villagebanking.org/home.php3.

Other references:

- Hirschland M. (2002), *Savings operations for very small or remote depositors: some strategies* (www.microfinancegateway.org/viewpoint_savings.htm).
- Marconi R. (1998), "Oferta de servicios de depósitos en el área rural en Bolivia". In: FINRURAL, PROFIN/COSUDE (eds.), *Movilización del Ahorro Rural en Bolivia: Tarea Impostergable*, La Paz, Boliva, 1998.
- NABARD (2002), The Radiant Link – Self-Help Groups Linkage Program. Serie of studies commissioned by NABARD, with financial assistance from SDC, GTZ, and IFAD (www.nabard.org/roles/mcid/microfinance.htm).
- Robinson M. (1997), *Introducing Savings Services in Microcredit Institutions: When and How?* CGAP Focus Note 8, Washington DC.
- Taillefer B. (2001), *Manuel de la Mutuelle de Solidarité*, France (btaillefer@aol.com)
- Wisniwski S. (1999), *Microsavings compared to other sources of funds*, CGAP, GTZ, BMZ, Eschborn.

Box 2

Techniques for indirect savings mobilization

- Examples from different countries around the World -

When microfinance institutions (MFIs) are not legally allowed to take in deposits from their clients, they can use different techniques of intermediation between their clients and a licensed financial institution (generally a commercial bank or a savings and credit cooperative). This provides a mean for poor households who do not “like” banks to get access to a safe place for their savings. For the MFI, it is a means to better serv e their clients and perhaps to obtain credit lines from the bank in the future. Finally, for the bank or cooperative it reduces administrative costs.

An MFI can help members of a village bank, of a solidarity group or an association to manage their savings. taking in savings from members and depositing them, assisting with other transactions administering advice on how to calculate interest rates, etc., and generally educating such clients on banking systems.

Example (from Marconi, 1998): ANED (Asociación Nacional Ecuménica para el Desarrollo) in Bolivia applies the following methodology:

1. ANED gives a credit to the “savings and credit board” (Junta de Ahorro y Crédito) of the community association, which intermediates the credit to its members, through solidarity groups.
2. The members pay back regularly capital and interests to the board, which gives it immediately to ANED.
3. The community association owns a fund built up by 1/3 of the final interest rate.
4. This fund allows to give short term credit to the members and gets capitalized through interest rates.
5. Members can save on a voluntary base and withdraw without restriction. The money is deposited in a bank, given that ANED is not authorized to take in deposits from its members.
6. Savings can also be used to give credits to the members. ANED assumes the role of a cash desk when a member has an urgent need to withdraw savings.

An NGO can coach self-help groups to save fixed amounts of money during weekly or monthly meetings and deposit them in a bank. It can then also link the group to a bank in order to give access to credit. The most famous example is the linkage technique between Self-help groups and NABARD in India.[24] Similar experiences exist in Mexico, Niger, Zimbabwe.[25] In Niger, CARE trains local promoters to organize women groups of about 30 members (by now, about 5’000 groups exist). Women in the groups commit to save small amounts periodically over a period of one year; the savings are then being used to make loans.

In West Africa, professional deposit collectors earn their money from collecting savings on a regular basis, mostly from people working on markets. They charge a fee for that service. The Ghana Commercial Bank has its own deposit collectors, who keep passbooks of clients’ deposits. The clients have the same passbook, which is checked by an officer every now and then. The bank does not charge for that service. One could imagine that NGOs/MFIs take the role of deposit collectors on a contractual basis with the bank.

[24] See series of publication by NABARD (2002).
[25] Hirschland (2002).

Box 3

A strategic alliance between a regulated private financial fund and a non-profit microfinance organization in Bolivia

(By Cecilia Campero, Deputy Director of PROFIN, Bolivia)

Since 1985, the Fondo para el Fomento a Iniciativas Económicas (FIE) offers financial services for the development of micro and small enterprises of limited economic resources and unable to access the conventional banking system for loans. In 1998, FIE became a regulated Private Financial Fund (FFP: Fondo Financiero Privado) under the control of the Superintendency of Banks and Financial Institutions. As of September 2003, FIE FFP had a loan portfolio of $US 37.2 million with more than 29'000 borrowers and a level of savings of $US 20 million with approximately 18'000 accounts.[26]

Programas para la Mujer (Pro-Mujer) is a non-regulated NGO that provides credit and business development services to self-employed women in the peri-urban areas of Bolivia since 1994, using the village bank methodology. As of September 2003, Pro-Mujer had an outstanding portfolio of $US 4.5 million with more than 35'000 borrowers and an average loan of $US 128.

The two entities in their search to better serve their clients and in order to provide access to savings to a population that does not have this type of opportunity, decided to establish a strategic alliance that has started with a pilot project in 9 branches (centros focales) of Pro-Mujer in the cities of El Alto, Tarija and Cochabamba.

The regulatory framework under which this project functions is described as "external cashiers" (cajas externas) under the norms for banks and financial entities.[27] Basically, FIE FFP opens a cashier inside a Pro-Mujer branch and provides the following services to the Pro-Mujer clients and to other potential clients in the area:[28]

- Access to savings (savings accounts and time deposits)
- Payment of basic services (water, electricity and phone bills)
- Transfers
- Money exchange.

Before this project started, Pro-Mujer clients had to deposit their mandatory savings and the saving of their internal fund (revolving fund characteristic of the village bank methodology) in regulated financial institutions, normally located far away from Pro-Mujer's branches (centros focales). With this alternative, the Pro-Mujer clients can deposit their savings at the same branch where they obtain credit, reducing transaction costs and avoiding possible cases of robbery. In addition, the Pro-Mujer clients have access to a variety of services that the NGO cannot provide, such as payment of basic services, money exchange or transfers.

For the FFP FIE, this strategic alliance is a way to fulfill its mission by reaching new clients in peri-urban areas and expanding their points of service for its own credit clients. Furthermore, the FFP FIE can capture savings (in the form of savings account and time deposits) from new clients and receive a fee for the payment of basic services or wire transfers.

The 7 "external cashier" of El Alto were opened between March and September 2003, and the ones in Tarija and in Cochabamba started operating in October 2003. As a result of this innovative alliance, 500 village banks have opened savings accounts and given that each bank incorporates approximately 18 members, a total of 9000 women have been served. Consequently, with this alliance, FIE FFP has achieved a level of savings of $US 1.3 million with 9000 accounts and an average of $US 144 per person. Furthermore, Pro-Mujer has deposited $US 500'000 of institutional savings in the FIE FFP accounts, amount that was previously deposited in another regulated institution.

In 2004, the project will be replicated and expanded to at least other 4 secondary cities where Pro-Mujer has centros focales.

[26] ASOFIN (2003), *Boletín Informativo: Información Especializada en Microfinanzas*, La Paz – Bolivia, September 2003.
[27] Collao Kathia (2002), *Proyecto de Complementación de Servicios entre el FFP FIE y Pro-Mujer,* La Paz – Bolivia.
[28] Through an agreement between Pro-Mujer and FIE FFP, the latter is not allowed to provide credit to the clients of the former.

Box 4

Market saturation and over indebtedness during the Bolivian crisis

(By Cecilia Campero, Deputy Director of PROFIN, Bolivia)

The first signs of market saturation started in 1999, mainly in the urban markets on the main cities (the axis of La Paz, Cochabamba and Santa Cruz) and was caused by the over-supply and over-disbursement of loans. The saturation was reflected mainly by the high delinquency in many clients. Due to the easy access to credit provided by the institutions, clients began to borrow from several institutions (an average of 2 loans), and using in some cases the proceeds of a loan to pay their debts with other financial institution (financial bicycling phenomenon).

Therefore, the number of clients who could fulfil their obligations with financial entities diminished. In addition, the socio-economic crisis was detrimental to the micro entrepreneurial sectors, reducing income and therefore the repayment capacity of many clients. Furthermore, many clients after repaying their credits did not take new loans, or else, potential clients decided to postpone their application for credit.

Finally, given that many clients were not considered qualified borrowers anymore, MFIs did not have as many incentives to capture savings since the possibility of allocating them as credit funds was reduced.

3. Product development, diversification and innovation

3.1 Introduction

Households with low and unstable income save in different forms, for diverse reasons and purposes, and entrust their savings to various persons or institutions. Microfinance Institutions (MFIs), which attempt to respond to the demand for financial services of this target group have to take into account the diverse needs in their product offer. This short note will provide the reader with hints and advices on how an MFI should proceed before launching savings products. Examples of savings services and products from financial institutions around the world targeting low-income households will supply insights and ideas for innovation and diversification.

The present note is structured as follows:

1. Critical success factors before implementing savings services
2. Designing adapted products
3. Overview on existing basic offer
4. Diversification and innovation
5. Conclusions

3.2 Critical success factors before implementing savings services

Before starting to offer savings and deposit services to its clients, an MFI should **fulfil a certain number of conditions** (see chapter 2), i.e. a strong management, tending towards financial viability, a strong capital base, reflect an image of confidence among the public, and dispose of internal and external control mechanisms. If the institution is not ready yet and/or is not allowed to take in deposits, it can implement some kind of **intermediation mechanism** (see boxes 2 and 3).

Clients who have lost confidence in a financial institution because they could not withdraw their savings when needed are difficult to win back. Hence, the MFI should **introduce the new service in a professional and stepwise manner**. Practice from all over the world shows that institutions might need between one and two years of research and pilot testing before launching a new service (Wisniwski, 1999).

First, the MFI should conduct **market studies** to analyse the potential demand of their existing clients. They should also analyse the services provided by other financial institutions in their region, and/or other financial institutions who target the same type of clients. Important aspects to be analysed are the service delivery structure, competitive characteristics of the service (prices, terms, minimum amounts, variety, etc.), interest rates in different institutions, and profile of clients who demand the service (WOCCU, 2002). Second, the institution should perform field **pilot testing**, adjustments and retesting on a small scale. Third, many financial institutions introduce innovative **marketing** strategies, such as patronage of social events and networking with local authorities and community leaders, to promote the service on a large scale (Wisniwski, 1999). A detailed step by step procedure is provided in Bankakademie (2000).[29]

[29] See also the product development tools on www.microsave-africa.com.

3.3 Designing adapted products

"**The poor are not a homogenous group with broadly similar needs**".[30] Households save for diverse motives (see box 5), in diverse and multiple (formal and informal) manners and with different time horizons (see chapter 1).

Box 5:

For which motives do poor households save?

1. To decrease their vulnerability to shocks (income, health, death, etc.).
2. To accumulate lump sums for:
   - life-cycle needs (birth, wedding, death).
   - investment in human, physical and social capital.
3. To bequeath relatives and friends.
4. To obtain a credit.

Women are known to spend relatively more money than men on health and education expenses for the family. Some women who want to put aside regular small amounts of money, may need to hide their savings from their husbands until they withdraw it, to pay school fees or for medical care. Men usually invest all their savings in the business, buying cattle, equipment, inputs, etc. They may save in order to accumulate lump sums. For example, mechanisms that combine saving by the client, previous to a leasing from the financial institution, could facilitate investment in productive assets. It might be beneficial for school children to learn to save small amounts of money in order to participate in a lottery for example, where they can win a bicycle.

Because needs are so heterogeneous, savings services should **balance liquidity and return**. Either products are very liquid[31] and accessible at any time, but pay low or no interest, or they are blocked for a pre-determined period, but pay higher interest. Very liquid saving products will serve the purpose of responding to poor people's emergency expenses, while illiquid savings will force them to discipline, and be used to plan the purchase of a house or land. In between, savings will serve to respond to life-cycle expenses (birth, wedding, death, etc.), which can be planned with more or less certainty. Poor people look for a mix of accessibility, security, discipline, discretion, and (ideally but not crucially) return (see box 6).

Box 6:

Under which conditions do poor households save?
(from Rutherford, 1996, and others)

1. They feel their savings are secure.
2. The amount of their savings is kept secret to others.
3. They can access all or part of their savings when needed.
4. They have the possibility to save often and easily.
5. They are entitled to obtain a credit (reciprocity).
6. They feel they own their saving (their savings are not owned by a group).
7. They feel the savings are growing and protected from inflation.
8. They feel under some social pressure to save.
9. They know at any time how much they have.

Case studies from different countries show that MFIs **offer a mix of savings products** with different levels of liquidity and return (Wisniwsi, 1999, and CGAP, 1998). Individual and voluntary

[30] Hulme and Mosley (1997), cited in UNDP-Africa (2002).

[31] The more liquid an asset, the quicker it can be transformed into cash. A current account is very liquid, because you can withdraw money whenever you want. Time deposits are less liquid, as you can only withdraw money at the term.

savings are the most common. Interest rates are competitive in comparison to other institutions operating in the same areas.[32]

Minimum balances to open an account are kept low. Interest rates are adapted to the amount saved (no interest paid below a certain balance, or interest rate increasing with balance).

The offer ranges from simply designed products to complex market-segmented products. Trademarks, product labels and standardized logos are important to give products recognizable and memorable names associated with a quality image (see box 7).

3.4 Overview on existing basic offer

As mentioned above, MFIs should offer their clients a mix of savings products. The ideal combination, which is provided by most savings and credit cooperatives and commercial banks around the world includes:[33]

- **Current account or sight deposit**: bears a very low or no interest, is very flexible, requires very low opening balance, gives usually access to payment services (cheques, credit card, etc.).

  Example:
  Bank Rakyat Indonesia (BRI) offers a current account (called simpedes in rural areas and simaskot in urban areas) for small savers and groups who demand high liquidity. A small interest is compound and paid monthly on those accounts whose balance is over a certain minimum. Savers can participate in a free six-monthly lottery, using the amount in the account as a basis for issuing lottery coupons.

- **Savings account**: higher interest rate than current account but number of withdrawals limited to a few times per month; very low opening balance. This is the most known and used type of account. Often, the interest rate increases proportionally with the balance on the account, and sometimes, no interest rate is paid at all under a certain balance.

  Examples:
  1. In Bangladesh, the Association for Social Advancement's (ASA) General Members Savings Account clients have to maintain a minimum balance of 10% of the value of their current loan principal, and have to deposit a fixed amount every week. They get paid an interest of 8% a year.
  2. Cooperativa San Roque in Bolivia uses this type of account to take in monthly salaries from public workers who live far away from where they are actually paid their salary.
  3. Fédération des Caisses d'Epargne et de Crédit Agricole Mutuel (FECECAM) in Benin offers a saving account with a 3% annual interest rate paid on the minimum quarterly balance. The member can apply for a loan on which 20% of the amount is blocked until the loan is repaid.
  4. In Mali, the Caisses Villageoises d'Epargne et de Credit Autogérées (CVECA) offer a savings plan, aimed at women who can only save small

[32] According to Wisniwski (1999), "…savers of private financial institutions in a competitive environment are more sensitive to the real rate of return than those of public financial institutions. Public banks might offer an implicit safety-net that seems to be very attractive in the absence of a formal deposit-insurance system."
[33] Examples are provided by Wright et.al. (2000), CGAP (1998) and Marconi (1998).

amounts based on the tontine scheme. Women commit themselves to pay a fixed amount during 24 or 48 weeks and receive an average interest rate of 10% a year.

- **Time deposit or term deposit**: high interest rate, relatively high minimum opening balance, withdrawal only at term. Mainly used by richer households who want to save for a longer term goal. In most cases, these long term contractual savings can be withdrawn before term if an emergency occurs, but clients loose part or all of the accumulated interest.

  Examples:
  1. ASA's Long Term Savings Account is a five-year contractual savings scheme, requiring a fixed monthly contribution. After five years clients receive their savings with a compounded 9% interest rate per year. If they do not deposit on time, they have to pay a fee and after five missed deposits, the account is closed and part of the interest is lost.
  2. Cooperativa Hospicio in Bolivia offers the Intended Savings Account on which clients save regularly for a precise purpose (investment) and receive a complementary loan at a fixed term.

3.5 Diversification and innovation

Many financial institutions have diversified their offer in order to address special client segments (children, elderly, clubs and associations) or special purposes (pilgrimage, education, housing, retirement, marriage, emergencies, etc.). Many products have been inspired from traditional informal savings systems such as ROSCAs, tontines, Munno Mukabi, etc. Some institutions have invested in information technologies in order to reduce the cost of delivering savings services in remote rural areas (see the example of PRODEM's Smart Card in Box 8).

The examples below are listed according to the different saving motives shown in box 5:[34]

Decrease household's vulnerability

Health-care savings product: can be implemented in regions where people are subject to seasonal sicknesses, such as malaria. Clients can take a loan from this account, which they secure with a term deposit not yet arrived at term.

Life-insurance: members of the Besaoa cooperative in the Philippines can subscribe to the Mortuary Aid Plan and make an annual contribution. If a member dies, her or his heirs receive compensation from the cooperative. Sonapost in Burkina Faso has made a partnership with a local insurance company to provide life insurance to depositors holding sight deposits or savings accounts.

Emergencies: clients who have a contractual savings account (for example for housing or education) can get a loan for an emergency case, guaranteed by the contractual saving.

Respond to life-cycle needs

Wedding: contractual savings account that calls for small periodic deposits over an extended period of time. In South India social groups like churches arrange funds which allow members to save regularly

[34] When no institution is mentioned, the example is taken from Mutesasira (2001), who suggests a wide range of possible innovations. The examples from institutions are taken from WOCCU (2002), Bankakademie (2000), Wright (1999), CGAP (1998).

over a long period of time for the marriage of their children. These funds are kept in a bank account.

Retirement: WOCCU (World Council of Credit Unions) suggests its cooperatives to offer a retirement account for savers who seek to maximise returns for long-term planning. The minimum balances at opening and thereafter are high, and withdrawals are restricted until reaching the age of retirement. Small Farmers Cooperative Ltd. in Nepal offers Provident Funds to their employees, which they can withdraw when they retire.

Funeral: in East Africa, people have set up informal schemes to save for burial costs of the family, which tend to be very high. People regularly save small amounts until they feel confident that they are able to cover the costs of a funeral.

Invest in human or physical capital

Education: savings accounts to pay schooling fees are quite popular everywhere. Some are periodical, paying for primary and secondary school fees once or twice a year. Other education savings accounts respond to longer term needs of lump sums, to invest in university studies, which have become expensive in many places. The frequency of deposits should be in accordance with people's income flows. The Rural Bank of Talisayan, Philippines, offers the Time Deposit Plus, which is a five year instalment savings plan targeted towards paying for educational expenses. Clients of this service can participate in a lottery and borrow up to their amount saved for emergency purposes.

Housing: a home ownership savings product could be designed to assist people in acquiring a home. People could save small amounts of money over a long period of time and accumulate a lump sum to buy building material in big quantities. This could allow the money to gather interest until enough materials could be purchased to complete a project.

Productive assets or durable goods: FECECAM in Benin offers an Investment Savings Plan which combines agreed regular prior saving with a loan or a leasing, so that it is easier for members to access productive capital goods (plough, flour mill, sawing machine, etc.). This helps reducing delinquency risks.

Bequeath relatives or friends

With its Patriot Term Deposit FECECAM targets urban people wanting to contribute to the development of their region of origin, another region with which they have ties, or of an institutional client or an NGO. Terms of 6, 12 and 24 months are scheduled with a minimum and a maximum balance. At term, an authorized person in the region of destination can withdraw the savings.

3.6 Conclusions

- Needs and demands for savings services are very diverse among low-income households, addressing saving for short-term and long-term purposes.
- MFIs, which seek to respond to existing diverse demands, as well as to capture significant amounts of deposits, should have a diversified portfolio of savings products.
- The mix of products should balance liquidity and returns. Very poor clients need to have quick access to their savings and are usually not too concerned about returns, as they keep low balances.

- On the other hand, interest rates are important to those who save bigger amounts for longer term goals.
- Examples show that MFIs offer an enormous diversity of savings services, very often inspired from traditional informal savings schemes.
- Institutions should proceed stepwise and professionally when introducing savings services, analysing the existing offer and the potential demand of their clients.
- Those institutions that offer contractual savings schemes show a certain flexibility with regard to emergency withdrawals, either by offering credit or access to savings with reduced returns.

3.7 More information and links

Suggested readings:

Wright G. (1999), *A Critical Review of Savings Services in Africa and Elsewhere*, MicroSave Africa, Uganda (downloadable on website mentioned below).

WOCCU (2002), *A Technical Guide to Savings Mobilization: Lessons from the Credit Union Experience,* Washington DC (downloadable on website mentioned below).

Websites with downloadable publications:

MicroSave Africa: www.microsave-africa.com

WOCCU (World Council of Credit Unions): www.woccu.org

Other references:

- Bankakademie (2000), *Marketing for MFI Depositories – A Toolkit for MFI Institutions*, GTZ (eds.), Germany.
- CGAP (1998), *Proceedings of the Africa Conference – Savings in the Context of MFI*, Kampala, Uganda, February 1998.
- Marconi R. (1998), "Oferta de servicios de depósitos en el área rural en Bolivia". In: FINRURAL, PROFIN/COSUDE (eds.), *Movilización del Ahorro Rural en Bolivia: Tarea Impostergable*, Bolivia.
- Mutesasira L. (2001), "Savings and needs in East Africa: an infinite variety". *Small Enterprise Development*, vol. 12, no. 3, September 2001.
- Rutherford S. (1996), "A Critical Typology of Financial Services for the Poor", *ActionAid and Oxfam*, London.
- UNDP-Africa (2002), *Summary Savings Policy Statement*, January 15, 2002
- Wisniwski S. (1999), *Savings in the Context of MFI – Lessons Learned from Six Deposit-Taking Institutions*. GTZ, Germany/MicroSave Africa.
- WOCCU (2002), *Striking the Balance in Microfinance – A practical Guide to Mobilizing Savings*. Eds.: B. Branch, J. Klaehn, Washington DC, Pact Publications.
- Wright G., Peck R., Matin I. (2000*), ASA's Culture, Competition and Choice: Introducing Savings Services into a MicroCredit Institution*, MicroSave Africa.

Box 7

Mushuc Runa: An experience of savings mobilization in rural areas of Ecuador

"When we needed credit in order to develop our productive activities, banks and urban cooperatives would not attend us, first because they had no interest in serving the rural sector and second, because of racial segregation. This motivated us to create our own institution." This was the main reason why a group of indigenous leaders of Chibuleo, a small community in the Ecuadorian mountains (located 3500 meters above see level and at one hour distance from Ambato) decided to create a savings and credit cooperative called Mushuc Runa (new man). Although the initial justification for setting up the cooperative was to provide access to credit, the leaders quickly became conscious that savings mobilization was the only way to obtain working capital for the institution. The savings and credit cooperatives are authorized to take in deposits by the Cooperative Law.

In the first phase, the cooperative only took in compulsory savings, as a prerequisite to obtain a loan of an average amount of US$ 70. Step by step, Mushuc Runa's activities increased and at the same time, the crisis in the financial system of Ecuador changed the perception of clients towards commercial banks. In the provinces and small cities, non conventional financial institutions gained more and more confidence from the public, which was the basic factor to save in these institutions.

In that context, Mushuc Runa has adapted more and more its intervention strategies:

a) Accessibility: the cooperative is located in the city, which allows to serve not only its members, but also persons from neighbouring communities who come to the city at least once a week to sell their production and buy inputs or food. The accessibility is further improved by flexible opening hours, including Saturdays and official holidays.
b) Diversified offer : although the institution initially only offered forced savings linked to credit provision, it quickly diversified its products to respond to the demands of clients who were asking for voluntary savings accounts and time deposits.
c) Improvement of operational and control systems: through the introduction of a computerized system for an instantaneous registration of operations, the institution has gained even more confidence from its clients. The control mechanisms will soon be improved even more through the submission under the specialized supervision of the Banking Authorities.
d) Diversification and risk control: the funds are allocated to a broad variety of credit clients in the rural population and the portfolio is adequately monitored for on- time repayments of credits. One of the slogans of the information campaign highlights the existence of 7000 safe deposit boxes to keep members' money.
e) Attractive interest rate: the cooperative pays a higher interest rate than other local financial institutions to its savers and investors.

The results of Mushuc Runa's approach translate into a high growth rate, high coverage and depth of outreach into low income, marginal urban and rural sectors, especially indigenous people. In September 2003 the institution had more than 30'000 depositors and US$ 8 millions of deposits, which represents its only source of funds to provide credit to its clients. The institution has demonstrated that a well managed and locally owned financial institution has a huge potential to mobilize deposits and provide funds to the benefits of the communities, contributing to the development of real financial markets.

	December 1998	September 2003
Total assets (US$)		10'800'400
Total deposits (saving accounts and time deposits in US$)	17'000	8'143'300
Number of members-savers	350	30'167
Average amount of savings (US$)	49	270
Total portfolio (US$)	19'000	9'559'200
Number of clients with outstanding loan		8'348

Box 8

Innovative solutions using information and communications technologies

The experience of PRODEM in Bolivia

(By Cecilia Campero, Deputy Director of PROFIN, Bolivia)

PRODEM Private Financial Fund (PRODEM FFP) is a regulated, privately held microfinance institution (MFI) constituted in Bolivia in 1999, with more than a decade of prior experience as one of the most successful non-profit microfinance organizations in the country. The main focus of PRODEM FFP is to provide sustainable financial services to micro, small and medium entrepreneurs in both rural and urban areas.

In a country where only recently savings products have begun to be developed for low income segments of the population, in part because 70% of the general population and more than 90% of the rural population are classified as poor, PRODEM has designed its own smart cards and ATMs with digital fingerprint recognition technology solutions to meet the needs of its rural customers and to face the following obstacles:[35]

- High communication costs restrain on line network
- High level of illiteracy in rural areas
- Systems security
- Lack of identification instruments (ID cards)

By using a combination of smart card technology with ATMs that allow fingerprint ID verification, PRODEM ensures that only the account holder can complete a transaction, making it more secure than typical ATMs that require a Personal Identification Number (PIN). Moreover, the ATMs are capable of “speaking” the local language of their users, thus illiterate customers can access the services through audio instructions in Spanish, Quechua or Aymara that guide the customers using vivid colours coded touch screens, until the transaction is finished.

In addition, the smart card eliminates the need to fill out deposit or withdrawal slips and the client no longer has to present an ID, which is specially important in rural areas where ID documentations are scarce. Furthermore, the smart card stores the entire customer’s personal and financial data by using an embedded microchip. As a result of these innovations, the ATMs are able to verify the customer’s identity and complete transactions without being electronically connected to the central office, thus allowing PRODEM to expand its reach into remote areas.

Since the smart cards were introduced in May 2001, PRODEM FFP has become the main player with the largest market share in the area of deposits among other FFPs in the country. As of September 2003, PRODEM FFP has achieved a level of savings of $US 14.2 million with more than 46’000 accounts with an average of $US 309 per account.[36]

PRODEM has the largest branch network in Bolivia, with 63 offices that span both urban (23) and, specially, rural (40) areas in all nine Departments of the country. Savings accounts with smart cards can be obtained in all 63 branches and the customers only need $US 10 to open an account and a maintenance fee of $US 7 per year, payable one year after the account has been opened. Additionally, the customers have 24 hour access in 34 agencies where ATM´s have been installed.

Security, simplicity, accessibility, quickness and the reach of this innovative instrument has made PRODEM FFP a success story in savings development with 3000 new accounts per month.

[35] Bazoberry, Eduardo (2003), “*Rural Financial Institutions: Savings Mobilization. The Bolivian Experience of the PRODEM Private Financial Fund S.A.”*, Case Study in Paving the Way Forward for Rural Finance: An International Conference on Best Practices.
[36] ASOFIN (2003), *Boletín Informativo: Información Especializada en Microfinanzas,* La Paz, Bolivia, September 2003.

4. Legal and economic framework for savings mobilization

4.1 Introduction

This chapter presents important aspects related to macroeconomic conditions and regulatory framework in which savings mobilization takes place. Some key questions should be asked before designing a regulatory framework that allows microfinance institutions to mobilize voluntary savings from their clients. Are there macroeconomic situations where saving mobilization should not be promoted? What shall be done instead? Which legal and regulatory framework should be fostered for MFIs ? What alternatives are available to protect clients' savings? What may financial authorities do and not do? These are some of the questions that we address in this note.

In technical note on saving no. 1, we have seen that poor households handle a broad variety of saving forms. Specialists and practitioners often argue that saving cash in a financial institution has more advantages for the poor than saving in physical assets or in kind (land, livestock, inventory, jewellery, etc.). Liquidity, divisibility, low transaction costs, discretion, security and intermediation between households are the often-cited advantages of monetary savings. Others argue that investments in physical assets are more appropriate for poor households, because they yield higher returns than monetary savings, and are more widely accepted. We believe that in cash savings deposited in a financial institution should not be seen as a substitute of in kind savings, but rather as a complement. Saving in a financial institution should provide those advantages that saving in kind does not.

While the financial institution itself can ensure advantages like liquidity, divisibility, low transaction costs and discretion, other advantages, like security and intermediation strongly depend on the legal, political and economic environments of the country in which the institution operates.

4.2 Macroeconomic and political framework

From the customer's point of view, a stable macroeconomic and political situation is crucial in fostering their confidence in financial institutions. In a highly inflationary context, savers will not be motivated to deposit cash in an institution. They may rely on in kind savings, whose real value is maintained, and which usually yield higher returns. Hyperinflation, and more generally macroeconomic instability, have triggered many financial crises in the world (Llewellyn, 1999). Hence, it would not be appropriate to promote savings mobilization in MFIs during macroeconomic or political turmoil. But macroeconomic crises and hyperinflation are temporary situations, and the promotion of monetary savings can be postponed until the economic and political situations are more settled.

Institutions that already mobilize savings can reduce the negative effects of inflation by constantly monitoring macroeconomic indicators, and through sound investment and interest rate policies. Exchange rate fluctuations and, more seriously, international financial crises represent other important risks that can affect financial institutions and thus, the safety of deposits. In the 1997 East Asian financial crises, which hit Indonesia particularly hard, the microfinance sector in that country (Unit Desa of Bank Rakyat Indonesia and others) remained untouched; it even won depositors that had lost confidence in commercial banks.

According to Robinson[37], "…a dramatic contrast became evident during the crises. The Indonesian financial system collapsed, but commercial microfinance remained stable and profitable." One of her arguments to explain the phenomena is that most clients of the microfinance sector were not concerned by the collapse of the Indonesian rupiah, as they did not rely on international trade. Moreover, the institutions themselves were not indebted on the international financial markets, as opposed to commercial banks, and were not concerned by corruption (insider lending, inadequate loss provision).

The possibility to intermediate monetary resources between different regions in a country is an important factor when talking about saving mobilization. MFIs should be integrated in a network and/or linked to the financial system in order to facilitate that intermediation. Institutions will also benefit, in the sense that they will be able to allocate their liquidities more efficiently between regions with different needs in terms of saving and investment. The overall economy of the country will gain from a more efficient distribution of resources.

[37] For more information on the Indonesian crisis and its impact on microfinance institutions, see chapter 15 in Robinson (2002).

4.3 Legal framework

Why regulate and supervise deposit-taking institutions?

The main objectives of supervising financial institutions are to protect savers from losing their money and the financial system from collapsing. If depositors learn that their bank is in trouble, they start to withdraw their money and bank runs may occur, even with healthy institutions. Apart from some exceptions, microfinance institutions do not represent a significant enough part of national financial systems to be a threat in that sense. Nevertheless, clients' savings have to be protected, in order to avoid cases such as the breakdown of the pyramid systems in Albania and the corruption of leaders in some savings and credit cooperatives.

Regulation and supervision of financial institutions should therefore contribute to professional management, transparency of operations and the protection of customers against abusive practices. Particularly in the context of financial services provided to low-income households, preventive measures can help avoid over-indebtedness and excessive interest rates and fees. At the same time, regulatory authorities should avoid creating a distortion of competition[38] between different financial intermediaries and avoid interfering in management decisions.[39]

What kind of supervision and regulation?

A universal rule for an optimal supervision and regulation of MFIs cannot be

[38] For example, if the state imposes an upper limit on lending interest rates, it might discriminate those "particular" financial institutions, which incur higher administrative costs because they attend clients with low and insecure incomes.

[39] Staschen (1999: p.13) provides detailed information on basic principles of regulation: competitive neutrality, efficiency, incentive compatibility, flexibility, cost-benefit analysis.

established. Those in charge of designing a system of supervision and regulation for MFIs in a specific country should first analyze the existing banking supervision and regulation, then investigate how the existing system can be modified and adapted, in order to take into account the particularities of MFIs (portfolio risk, size of operations, administrative costs, ownership structure, etc.). "Developing a new regulatory regime for microfinance takes a great deal of analysis, consultation, and negotiation; the costs of the process can exceed the benefits unless a **critical mass of qualifying institutions** can be expected".[40] Hence, a country should host a certain number of institutions, which have the capacity to fulfill regulatory requirements and the willingness to offer savings services to low-income clients[41], before starting to invest in regulatory framework adapted to MFIs.

There is a clear distinction between **prudential and non-prudential regulations**. Prudential regulation (see box 9) aims at protecting the financial market and its clients, in particular their savings, while non-prudential regulation is meant to enable financial institutions to operate legally.[42] The authorities in charge should "… avoid using burdensome prudential regulation for non-prudential purposes – that is, purposes other than protecting depositors' safety and the soundness of the financial sector as a whole".[43]

Box 9:

Prudential standards for microfinance
(From CGAP, 2002)

1. Minimum capital requirement (usually smaller for MFIs than for banks).
2. Capital adequacy (aims at maintaining a prudent relationship between risky assets and equity).
3. Unsecured lending limits; loan loss provision (should permit an equitable trade-off between unsecured loans and loan loss provision).
4. Loan documentation (minimum requirements should be made, but not as strict as for commercial banks).
5. Restrictions on co-signers as borrowers (should take into account MFIs group lending technology).
6. Frequency and content of reporting.
7. Legal reserves against deposits (should not be put too high, because translate in an additional cost to the financial institution).
8. Ownership suitability and diversification requirements (ensure proper control from owners through diversified interests).
9. Physical security and branching requirements (business hours and the location of branches might be particular in the case of MFIs).

As we are presently dealing with MFIs that take in deposits from the public, we concentrate on prudential regulatory measures. Box 9 contains the prudential standards that are usually applied to financial institutions and that should be adapted to the particular conditions of MFIs.[44]

Even when prudential standards are followed, financial institutions might get in

[40] CGAP (2002).
[41] See chapter 2.
[42] Non-prudential regulatory issues are: permission to lend, protection of borrowers against abusive lending, fraud and financial crime prevention, credit information services, interest rate caps, limitations on ownership, management and capital structure, tax and accounting treatment, legal form (for detailed information, see CGAP, 2002).
[43] CGAP (2002).

[44] For detailed explanations, see CGAP (2002).

trouble and may need to be saved from a collapse. The **lender of last resort** (LLR) and deposit insurance are the usual protective regulatory instruments. In most countries, the Central Bank plays the role of the LLR, through providing solvent financial institutions with liquidity during temporary liquidity crisis. The LLR protects the financial institutions from collapsing. Ideally, it should only help solvent institutions, but given the asymmetry of information and political pressure, the LLR may also help insolvent banks who occupy a key position in the financial market.

While the LLR directly protects the financial institution (thus indirectly depositors), **deposit insurance** provides direct protection to depositors. On one hand, this measure is very effective in avoiding bank runs, but on the other hand, depositors and institutions are less interested in monitoring their operations, given that in case of bankruptcy, they get full protection. Hence, the pressure from the public on the bank is not effective anymore. In order to maintain a certain pressure, deposit insurance should not protect the full amount of deposits, or the price of the insurance could be inversely proportional to the rating of the institution. A private insurance provider, e.g. in form of an association, can ensure a better control from outside the institution.

Which institutions should be supervised?

If the only aim of regulation is to protect deposits, the supervisory authorities should only supervise those **MFIs which offer voluntary saving services to their customers**. MFIs that are funded by other peoples' money (grants and concessional loans from donours, commercial loans, etc.) do not need prudential regulation. Nevertheless, they might be willing to undergo external supervision in order to give a signal of their financial soundness to prospective investors. It might also give them the possibility to access commercial funds at lower interest rates.[45]

In many places, **member based savings and credit cooperatives** are supervised by a government agency, which is in charge of the supervision of all kind of cooperatives and not specialized in savings and credit services. An effective supervision of big cooperatives is beyond the scope of their members and of a non-specialized government agency. Bigger savings and credit cooperatives should thus be supervised by a specialized financial authority.[46]

MFIs demanding cash collaterals from their debtors (forced savings) which are often deposited at a third party (commercial bank), may be authorized to operate without supervision. Actually, in such institutions, customers usually owe more to the institution than the institution to them.

In any case, authorities should analyze the needs of supervision for each type of institution present in their country, given that supervision is extremely costly and that supervisors often have to be trained on special MFI issues. **Small community based MFIs**, which take in deposits from their customers or members, may be

[45] In Kosovo, MFIs which do not take deposits must register with the supervisory authorities (Banking and Payments Authority) but must not meet prudential requirements. Nevertheless, they have to submit yearly reports to the authorities.

[46] In Latin America, direct supervision from the bank authorities of some or all credit unions is now required in many countries.

authorized to operate without supervision. But in such a case, customers and members should be fully informed about the fact that the institution is not controlled by any financial authority, and that their savings are not insured.

Who supervises and under which law?

Microfinance institutions might be supervised by three **different kind of institutions** (CGAP, 2002):
- Within the existing supervisory authority,
- By a self-regulatory and self-supervisory body,
- By delegated supervision.

They may be regulated and supervised under three **different kind of forms** (see box 10 for examples):
- Regulation by banking law,
- Regulation by a special MFI law,
- Self-regulation.

The supervision of microfinance institutions can be located **within the existing supervisory authority** for banks, with the advantage of larger financial resources and the credibility of regulation (with a few exceptions). The question is whether to create a separate department for MFIs? The answer will depend on the different country contexts (CGAP, 2002). Another question is whether MFIs should be regulated **under a special law or under the existing banking law**? Very often, MFIs do not have another choice than to adopt the conditions of commercial banks, because authorities do not want to set up a special law for MFIs. In such cases, MFIs might be able to **negotiate exemptions** that take into account their special features (administrative costs, equity requirements, risk structure, different collaterals, etc.).

On one hand, **regulation by a special MFI law** presupposes the interest from the legislator and the capability of the competent authority (both financial and know-how). On the other hand, MFIs should be ready and willing to submit themselves to statutory regulation. The process of elaborating a special law can be quite long, given that financial authorities have to learn about microfinance and that MFIs have to learn about regulation and supervision. The regulation should allow a fluid graduation to a commercial bank, which is the case of Uganda with its 3 level classification of types of microfinance institutions.

MFIs can decide to create their **own system of self-regulation** without recourse of the government. The advantage of such a system is that institutions have more freedom to innovate and take account of their special needs in terms of supervision. MFIs submitted to self-regulation can decide to adopt a code of conduct and to be refused a “stamp of approval” if they do not fulfill the code (Staschen, 1999). They may want to be self-regulated in order to put a signal for potential investors and create confidence for savers (provided they are authorized to take in deposits). However, experience tells that self-regulation of financial intermediaries in developing countries has rarely proven to be effective in protecting the soundness of the self-regulated institutions (CGAP, 2002).

Finally, the financial legal authorities can **delegate the supervision to an outside body** on which they keep control. This private independent body should be entrusted with enough authority to actually apply sanctions. Alternatively, supervision can be done by external auditing firms specialized in handling MFIs. A competent authority should revise the audits in order for that alternative to be effective.

A **combination of self-regulation and delegated supervision** by an accredited auditor can represent an interesting alternative for MFIs who wish to become regulated, when financial authorities have neither the capacity nor the political will to do it themselves. Nevertheless, in the mid term, an integrated solution, together with the supervision of banks will be more optimal.

4.4 Conclusions

- Savings mobilization should not be promoted in periods of high inflation and political turmoil, and those MFIs which are already engaged in saving mobilization should have a strong management to overcome inflationary periods.
- When exchange rate risk is a threat to the financial stability of the country, MFIs can protect themselves by avoiding taking credits on external financial markets and by placing their liquidities in a strong currency.
- The intermediation of financial resources between regions is advantageous for the institutions and the overall economy.
- MFIs that take in voluntary savings from their clients should undergo supervision and regulation, in order to protect clients' deposits.
- For the implementation of supervision and regulation of MFIs, no universal rules apply. Both the existing MFIs and the regulatory framework for banks should be analyzed first.
- The processes of elaborating a regulatory framework for MFIs might be time and money consuming. Hence, the willingness and interest of both parts (authorities and MFIs) should be a pre-condition for elaborating such a framework.
- If competent authorities do not have the capability and political will to establish such a framework, alternatives like self-regulation and delegated supervision are possible. They should nevertheless lead to an integrated supervision from the financial authorities in a predictable time horizon.

4.5 More information and links

Suggested readings:

CGAP (2002), *Regulation and Supervision*, Consensus Microfinance Policy Guidance, Washington DC. (downloadable on www.cgap.org).

Staschen Stefan (2003), *Regulatory Requirements for Microfinance – A comparison of Legal Frameworks in 11 Countries Worldwide*. GTZ, Germany (www.gtz.de/dokumente/bib/03-5226.pdf)

Staschen Stefan (1999), *Regulation and Supervision of Microfinance Institutions: State of Knowledge*, GTZ. (www.microfinancegateway.org/static/1643.htm)

Websites with downloadable publications:

www.cgap.org

www.microfinancegategeway.org (search under "regulation and supervision")

Other references:

- Addison Tony et. al. (2002), *Financial reconstruction in conflict and "post-conflict" economies*. Working Paper Series no. 40, Finance and Development Research Program, IDPM, Manchester, UK
- Berenbach S., Churchill C. (1997), *Regulation and Supervision of Microfinance Institutions. Experience from Latin America, Asia and Africa*. The MicroFinance Network Occasional Paper no. 1. Washington DC.
- Churchill C., Eds. (1997), *Regulation and Supervision of Microfinance Institutions. Case Studies*. The MicroFinance Network Occasional Paper no. 2. Washington DC.
- CGAP (2000), *The Rush to Regulate: Legal Frameworks for Microfinance*. Occasional Paper no. 4, April 2000. Washington DC (www.cgap.org)
- Fiebig Michael (2001), *Prudential Regulation and Supervision for Agricultural Finance*, FAO, AFR, GTZ, Italy.
- Llewellyn David T. (2000), *Some lessons for regulation from recent bank crises*. Paper presented at the Second International Conference on the New Architecture of International Monetary Systems, Florence October 15th, 1999. Loughborough University, UK (www.devinit.org/findev/Working%20Paper2011.htm).
- Robinson Marguerite (2002), *The Microfinance Revolution. Volume 2: Lessons from Indonesia*. World Bank, Washington DC.

Box 10

Example of experience with different regulatory approaches

(from Staschen, 1999)

1. Regulation by banking law

Although this kind of regulation implies a high entry barrier for MFIs, some successful examples of MFIs which have been licensed as banks show that in some set ups it is possible:

- *BancoSol* in **Bolivia** transformed in 1992 from a microfinance NGO (PRODEM) into the first private bank in the world to do business solely in the microfinance sector. In the past years, it has diversified its portfolio and has begun to provide large credits that represent only 2.2% of the number of loans but 32.2% of the portfolio volume (SBEF, Financial Bulletin, December 2002, La Paz, Bolivia).
- K-Rep Bank Ltd. in **Kenya** underwent its conversion into a formal bank in 1996, motivated by its inability to mobilize savings as an NGO. K-Rep Holding Ltd. spans the bank and the NGO; both entities have a clear allocation of tasks: while the bank offers financial services, the NGO focuses on development policy goals and has the tasks to train, advise and disseminate information. The NGO lives on fees and donour contributions.

2. Regulation by a special MFI law

The variety of existing laws is relatively large, although few countries have adopted a special law for microfinance institutions:

- In **Bolivia**, *Fondos Financieros Privados* (FFP) were introduced in 1995 into the banking law, as a new category of financial institutions, and supervised by the banking supervisory authority. The difference with banks was that FFPs needed only one third of initial equity capital to start operations (US$ 1 million), but were not allowed to take in sight deposits, conduct import/export transactions, conclude direct investments and manage investment funds. *Caja Los Andes* was founded as the first FFP in 1995. The new banking law of December 2002 permits FFPs to take in sight deposits and conclude direct investments.
- In **Peru**, a special regulatory framework for MFIs was adopted very early. In the 1980's, the financial authorities created an institutional type modeled on the German savings banks, the *Cajas Municipales de Ahorro y Crédito* (CMAC), with its umbrella organization, *Federación Peruana de CMAC* (FEPCMAC), which performs appraisal, advisory and training tasks. In 1994, a second regulatory framework was created in order to allow NGOs to become regulated financial institutions, under the title of Entidad de *Desarrollo para la Pequeña y Microempresa* (EDPYME). Both CMACs and EDPYMEs are regulated and monitored by a special department within the Peruvian central bank.
- In 1996, members of the **West African Economic and Monetary Union** (UEMOA) adopted a special law to control the microfinance sector and protect savers, *Loi PARMEC (Projet d'Appui à la Réglementation des Mutuelles d'Epargne et de Crédit).* The finance ministries in West Africa set up special monitoring units, *CAS/SMEC (Cellule d'Appui et de Suivi des Structures Mutualistes ou Coopératives d'Epargne et de Crédit)*.
- **Uganda** has adopted a three tier system, that is currently being adapted to Kenya and Tanzania. In this last country, a community bank can operate only in its district but only needs 50'000 US$ of minimal capital to operate.
- El Salvador and Albania, among others, have adopted special laws for MFIs.

to continue

(Box 10)

3. Self-regulation

In countries where the financial authorities are not willing to regulate and supervise the microfinance sector, MFIs may join together and adopt common standards.

- In the **Philippines**, NGOs, government agencies, and other microfinance experts from business and science have formed the Coalition for Microfinance Standards in 1991. This group develops operating and financial standards for more effective and efficient delivery of financial services to the Filipino poor.
- In **South Africa**, common-bond financial institutions (cooperatives and associations) are exempted from regulation under the Banks Act, but they have to join the relevant umbrella organizations (Savings and Credit League of South Africa, SACCOL, and National Association of Stokvels[47] of South Africa, NASASA). As the NGO sector is very advanced in that country, an initiative to establish a prudential regulatory framework for MFIs emerged at the end of the 90ies. Two competing lobbying groups coordinated activities: the Alliance of Micro Enterprise Development Practitioners (AMEDP), representing the interest of NGOs and MFIs, and the Association of Micro Lenders (MLA) as a lobby for professional moneylenders. Both have two main reasons to regulate the sector: protect consumers from exploitation without statutory intervention and access to refinancing through wholesale depositors.

[47] The South African term for RoSCAs (Rotating Savings and Credit Associations).