



THE TRUE COST OF DEPOSIT MOBILIZATION Deposit Costing Project Draft Report, December 2007

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Introduction

Microfinance institutions (MFIs) seem to be of two minds about the cost of mobilizing savings. In a recent CGAP study², the majority of institutions interviewed perceived deposits as the cheapest form of funding available, as well as stable, plentiful, and a valuable service to clients. However, many institutions perceive savings mobilization to be a very high-cost activity, necessitating fees and/or minimum balance requirements that can exclude poor clients.³

Actual data on the true costs of mobilizing deposits from poor people, however, are in short supply. Few institutions calculate the all-in cost of deposits (including financial costs and administrative costs), and even fewer figures are available publicly. This data is essential for institutions to make appropriate decisions regarding product pricing and capital structure. Knowing the major drivers of cost is also crucial to taking appropriate cost-cutting measures.

With this in mind, CGAP investigated the true, all-in cost of deposits at five different financial institutions serving poor clients using activity-based costing (ABC)⁴. The goal was to determine a) how expensive it really is to mobilize deposits from poor people, and b) where costs can be reduced by identifying major cost drivers.

The institutions selected for this study are of different institutional types and serve different types of clients on different continents. However, they all use deposits as an important source of funding (see table 1).⁵ This paper presents comparative findings related to deposits from all five ABC exercises.

¹ The authors would like to thank Lorna Grace, Indrajith Wijesiriwardana and Alvaro Tarazona, consultants, who greatly contributed to this report.

² MFI Capital Structure Decision Making: A Call for Greater Awareness, CGAP Brief, August 2007

³ See for example: Deshpande, "Safe and Accessible: Bringing Poor Savers into the Formal Financial System"; Richardson, "Going to the Barricades for Microsavings Mobilization: A View of the Real Costs from the Trenches."

⁴ CGAP's MFI Product Costing Tool tailors the ABC methodology for use by microfinance institutions. Although the Tool applies equally to all products (credit and savings products), this paper focuses on analyzing costs for savings products only. See Annex 1 for more information about ABC.

⁵ For confidentiality purposes the participating institutions will be referred to by the names of their countries.



Table 1: Characteristics of Participating Institutions

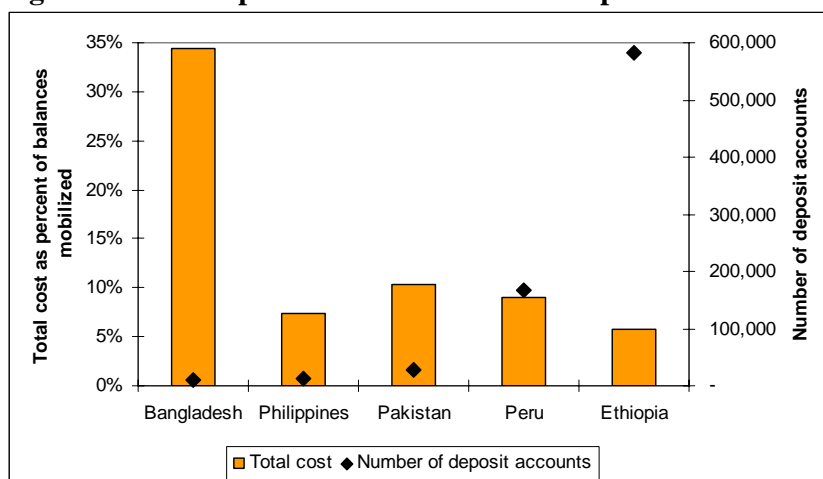
	Ethiopia	Peru	Pakistan	Philippines	Bangladesh
Type of institution	NBFI	Caja municipal	Microfinance bank	Cooperative bank	NGO
Number of deposit accounts	582.783	165.960	27.937	11.859	9.960
Assets (US \$ thousands)	52.680	168.304	24.295	3.495	408
Total deposits (US \$ thousands)	19.905	122.539	10.887	2.531	229
Avg. deposit balance (US \$)	34	738	390	213	23
No. of personnel	1.890	406	258	27	90
No. of branches	175	23	27	3	8
ROA	7.9%	6.9%	0.1%	1.8%	1%
Operating expenses / Loan Portfolio	6%	8.3%	38.5%	21.5%	35.3%

Note: NBFI=Non-Bank Financial Institution; Caja municipal is a non-bank financial institution; NGO=Non-Government Organization; data as of December 2005.

Costs vary dramatically

The ABC studies revealed that total deposit costs varied dramatically among the participating institutions, from 34.4% of total average balances mobilized to only 5.8% (see figure 1). Scale is influential in these results, but does not appear to be determinative. The largest and smallest institutions by number of deposit accounts had the lowest and highest costs, respectively, but this trend did not hold up in the middle of the sample.⁶

Figure 1: Total deposit cost and number of deposit accounts at participating institutions



Note: Total deposit cost is the sum of interest and administrative costs.

⁶ Similar results were reported by Portocarrero, Tarazona and Westley in the paper: “How Should Microfinance Institutions Best Fund themselves?”

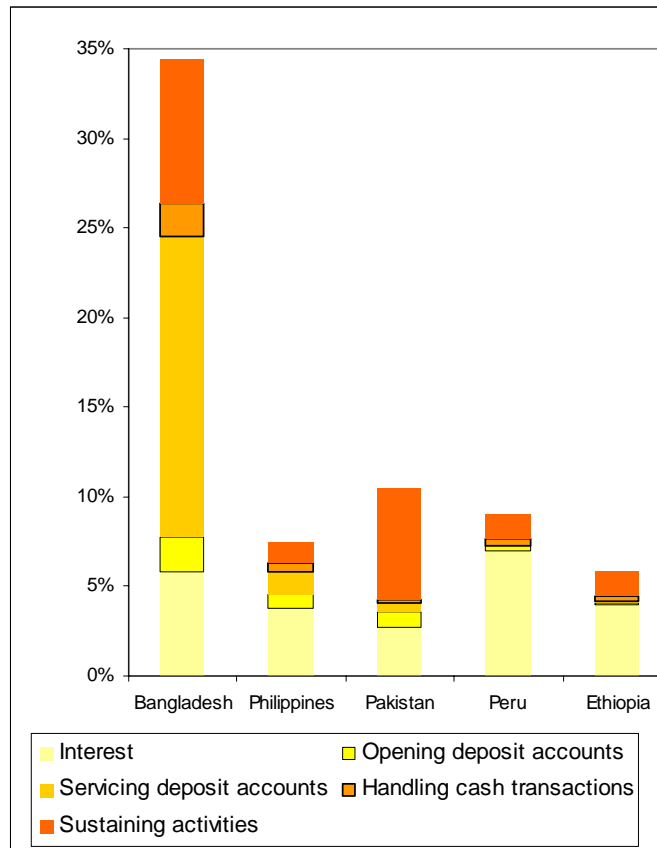


Breakdown of costs

Figure 2 shows the breakdown of total deposit costs at the institutions studied, including both the financial (interest) cost and the various components of administrative cost. Four major types of administrative costs, or “core processes,” were identified:

- *Opening deposit accounts*, which includes activities like group formation, helping clients fill out paperwork to open accounts, recording client information and documentation, issuing passbook and checkbooks;
- *Servicing deposit accounts*, which includes customer-facing and back-office activities for existing account holders (e.g. taking deposits from clients in the field through roving collectors, replacing or issuing new passbooks, helping clients fill out deposit slips, clearing cheques, closing accounts)
- *Handling cash transactions*, which refers to funds manipulation (e.g. recording cash in, deposits; and cash out, withdrawals), and back-office activities involving cash administration (e.g. supplying cash to branches, counting cash at the end of the day);
- *Sustaining activities*, which refers to all activities not directed exclusively to a particular service or product, but necessary for the operation of the institution (e.g. audit, risk management, internal control, etc.).

Figure 2: Financial and administrative cost breakdown at participating institutions (percentage of deposits mobilized)





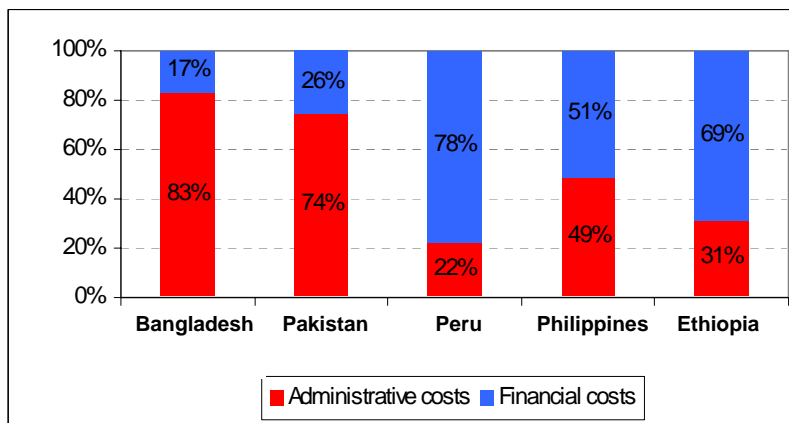
When total costs are broken down into these constituent parts, it becomes apparent that the way savings are mobilized – branches, roving deposit collectors, a combination of both – and the interest paid on deposits are important for lowering overall deposit costs.

For most of the institutions the major cost drivers were interest rate paid on deposits and sustaining activity costs. However, the most expensive single core process in *any* institution was servicing deposit accounts in the Bangladeshi institution – which exclusively uses roving deposit collectors, and, which cost the equivalent 16.7% of balance mobilized. The Filipino institution seems to offer an important alternative to the Bangladesh model: while serving roughly the same number of clients, the Filipino institution used deposit collectors only for the small minority of clients who are least likely to visit the branch. With similar numbers of clients, the cost of servicing deposit accounts amounted only to 1.2% of balances mobilized.⁷

Interest paid to depositors

A significant contributor to total deposit cost was financial cost, or the interest paid to depositors. Again, the five institutions exhibited significant variation in the proportion of cost represented by this variable from 17% to almost 80%, as illustrated in Figure 4.

Figure 3: Proportion of total deposit costs incurred by interest and operations



Simply looking at financial and activity costs as a percentage of the total may overstate the importance of interest as a cost driver. The three institutions where interest made up over 50% of total costs were the three institutions with the **lowest** overall cost of deposits. These institutions can in fact be seen as passing the fruits of their operational efficiency on to clients, in the form of interest. And, lowering interest would not produce a significant reduction in absolute cost.

Moreover, a breakdown by product reveals that most interest is paid on time deposit accounts, whose owners are more sensitive to changes in interest paid than regular savings or current accounts (see figures 4a and 4b). Offering higher interest rates on such accounts allows the institutions to attract larger deposits (especially time deposits) and reduce the overall administrative cost. To reduce interest paid could reduce the number of savers.

⁷ For more details, see Annex 4: *Comparing the Bangladeshi and Filipino institutions: Why do total balances differ so widely at these two institutions?*



It's important to understand the importance of interest as a cost driver, and to understand the market conditions and customer preferences of savers. In some cases, an institution might consider lowering interest rates – and using those funds to improve product or service offerings.⁸ For example, in the Ethiopian case, market research conducted by the institution revealed that interest was not as powerful an incentive for its clients to save as low minimum balances, transaction times, and distance to branches. So part of the resources currently spent on interest might have more impact if invested instead in additional service staff or an expanded delivery system.

Figure 4a: Financial and operational cost breakdown in savings deposits

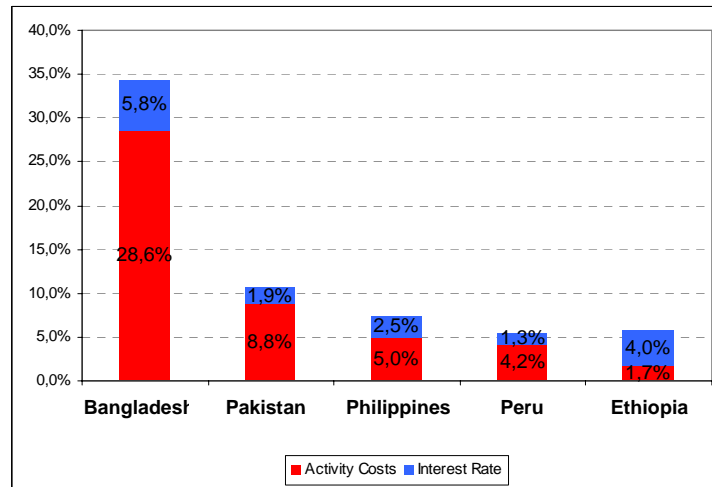
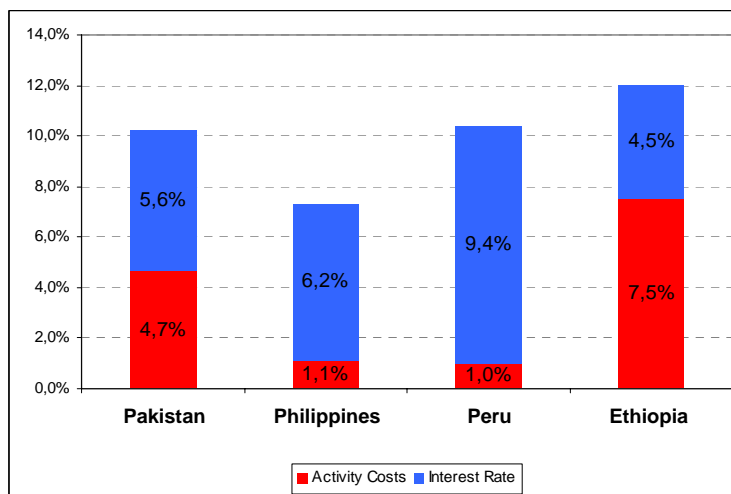


Figure 4b: Financial and operational cost breakdown in time deposits



Note: The Bangladeshi institution does not offer time deposits.

⁸ Much research has shown that return is not what low-income clients value the most in basic savings facilities, especially in immature markets where competition is not developed. See, for example, *MicroSave*, “Designing Savings Services for the Poor”, and CGAP’s Country-Level Savings Assessments at www.cgap.org/savings.



Sustaining activities: fairly consistent

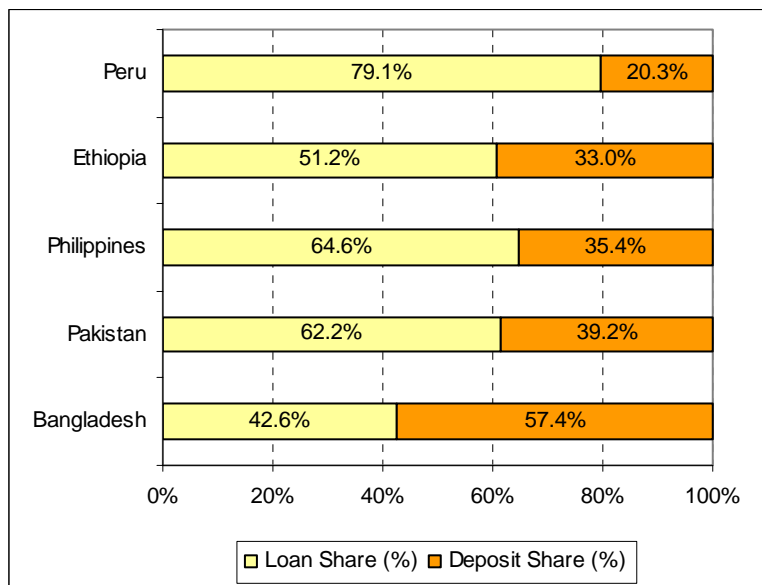
Sustaining activities were consistent contributors to cost in most of the institutions studied. In four out of five institutions, sustaining activities made up less than 25% of total deposit costs.

Table 2: Financial and administrative costs as percentage of total deposit costs at participating institutions

	Bangladesh	Philippines	Pakistan	Peru	Ethiopia
Interest	17%	51%	26%	78%	69%
Opening deposit accounts	6%	10%	8%	3%	2%
Servicing deposit accounts	49%	16%	5%	1%	0%
Handling cash transactions	6%	7%	2%	4%	5%
Sustaining activities	23%	16%	59%	15%	24%
TOTAL	100%	100%	100%	100%	100%

The levels of sustaining activity costs in these institutions may be most instructive in what they reveal about real operational costs (from opening and servicing deposit accounts and handling cash transactions). In most cases, operational costs are minuscule compared to the cost of interest and sustaining activities. Operational costs for deposits made up a significantly lower share of total operational costs than those for loans at four out of five institutions studied.

Figure 5: Average deposit and loan share of total operational cost across institutions



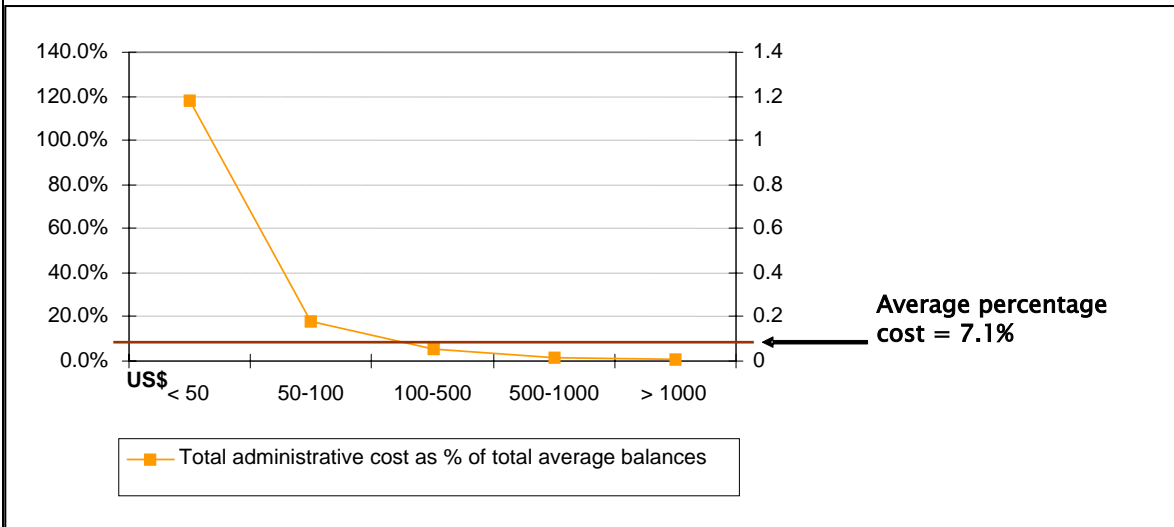


These findings are particularly important for MFIs that plan to introduce deposit services. Although launching deposit products requires large initial investments (in IT, MIS, staff), operational costs for deposits do not need to be high, and depend on the deposit product structure, delivery channels, and segment of clients served.

Peru: How much do small deposits actually cost?

A segment analysis in the Peruvian institution allowed us to analyze the cost of savings accounts with balances of different sizes. As illustrated by Figure 6, accounts with an average balance of less than \$100 cost more to administer than the total average administrative cost (7.1%), while larger accounts cost less.

Figure 6: Average costs by account size at Peruvian institution



It is logical that small accounts cost more than large accounts as a percentage of balances mobilized, for the same reason that small loans cost more to administer than large loans (on an average cost per balance): transaction costs. This pattern was visible across institutions, across different-sized accounts within the same product, and between products with different average balances within the same institution (savings accounts vs. time deposits, for example). In some cases, a simple deposit account can be a gateway product that can lead a low-income customer, over time, to other, more profitable products, like loans and money transfers. However, the rationale for offering small savings services is different for each market and for each individual institution.

Savings compared to other funding sources

The cost of deposits alone does not determine their attractiveness to institutions. For these five institutions, the contribution of deposit services to their social mission makes up for their impact on overall profitability. None of the institutions studied are motivated solely by profit – even though they are all profitable. This brings up an important distinction between the profitability of savings mobilization (and the institution’s operations overall) and the viability of savings. In CGAP’s ABC methodology, savings are considered unviable if they are more expensive than the next best available source of funds. However, if the all-in cost of savings allows an institution to on-lend them at a profit, savings mobilization can still be profitable.



Even for purely commercial institutions a lower profit outlook may still provide enough incentive for an institution to mobilize deposits: deposits can bring advantages such as stability of funds, reduced dependency on external borrowing, opportunities for cross-selling, and client acquisition and retention benefits. The choice between deposits and alternative funding sources should be made considering all these factors, not simply costs.

What starts out as a costing exercise, like these studies, generally morphs into a discussion about strategy and operations. Good information on costs – especially for a critical activity like savings mobilization – is key to making informed choices about the way an institution can best serve clients and shareholders alike.



Annex 1: Activity-based Costing in Microfinance Institutions

The purpose of all cost allocation methods is to assign shared, or “indirect,” costs to individual products, customers, branches, or other cost objects (sometimes called cost centers), as defined by an organization. ABC is a method of determining product costs that is particularly useful for service organizations like MFIs, where the main inputs to the “products” produced (like savings and loan services) are not physical but human. ABC assigns or “drives” input costs to different products based mainly on the staff time they require to produce, and the cost of that staff time.

The main operational difference in implementing traditional cost allocation and activity-based costing models is that the latter traces an institution’s costs to activities before driving them to products. These activities are then “used” or “consumed” by the different products, depending on specific attributes that drive activity costs (e.g., number of housing loan applications received, number of passbook savings accounts opened, etc.). A given product consumes many different activities. When these activities are added up, the total cost of delivering the product is revealed.

Briefly, the methodology proceeds as follows. First, the major types of operations conducted by the institution are identified and categorized into “core processes.” Each of these processes is then divided into the specific activities that make it up. This list is known as the “activities dictionary.”

After the activities dictionary is established, staff are interviewed to find out how much time they spend on each activity. The cost drivers for each activity must then be identified. Cost drivers are the event or item that causes costs to be incurred for a particular activity. The “unit cost” of each driver is then calculated by dividing the total cost of the relevant activity by the volume of cost drivers for that activity. The proportion of drivers arising from various products is then determined; for example, the number of transactions that are performed for different types of savings and loan products.

To arrive at a final product cost, all the costs from various activities driven to a particular product are added up. In the case of savings this total cost is then divided by the total volume of savings or time deposits to arrive at a percentage cost. Those costs are then compared with a number of other figures to calculate deposit product “viability” – that is, how well that deposit product compares with the cheapest alternative source of portfolio funding.

CGAP’s MFI Product Costing Tool tailored the ABC methodology for use by microfinance institutions. The Tool and accompanying Excel-based software is available at <http://www.cgap.org/productcosting/>.



Annex 2: Glossary of Costing Terms

Activity-based Costing (ABC)	A method that traces costs through significant activities to products or other cost objects
Activities Dictionary	Lists and defines all major activities performed by the institution
Administrative Costs	All recurrent costs except the cost of funds and loan losses
Allocation Basis	Method of assigning indirect and direct costs to cost objects based on modeling the consumption of these costs by cost objects as closely as possible
Core Administrative Costs	All administrative costs associated with core processes (i.e. not sustaining activities)
Cost Allocation	The assignment of identifiable items of cost (direct or indirect) to cost objects
Cost driver	An event or action that triggers an activity and allows for calculation of a unit cost
Cost objects	Cost units targeted for the costing exercise; can be products, branches, programs, customers, etc.
Direct Costs	Costs that can be identified specifically with or directly traced to a given cost object
Fixed Costs	Costs that remain constant regardless of activity or output levels
Indirect Costs	Costs that are not directly related to a cost object, but shared among cost objects
Interest Contribution	In viability analysis, the financial value of the savings product relative to a comparable funding alternative
Marginal Costs	The amount that costs increase when adding another product or product line (or decrease when eliminating a product or product line)
Net Administrative Costs	For savings products, administrative costs net of fees charged
Processes	Several activities directed to a common outcome or objective
Sustaining Activities	Activities that support the institution as a whole and are not easily traced to cost objects
Unit Cost	Cost per unit produced or per transaction
Variable Costs	Costs that change in proportion to levels of activity or output



Annex 3: Comparing the Bangladeshi and Filipino institutions: Why do total balances differ so widely?

Most of the Bangladeshi institution’s servicing costs come from roving deposit collectors.⁹ While the other institutions use branches to deliver deposit services, the Bangladeshi institution uses roving deposit collectors who visit clients in their homes and workplaces every day. This model is particularly useful for serving poor, remote, or busy clients who often do not have the resources or time to visit a branch.

However, the Filipino institution also uses collectors, and its cost of servicing deposit accounts amounts only to 1.2% of balances mobilized. The difference partly comes from the way each institution uses collectors. The Bangladeshi institution uses them to service all of its clients, while the Filipino one uses them for only a small minority who are least likely to visit the branch. So even though the two institutions have roughly similar numbers of clients, more Bangladeshi than Filipino customers are actually served by collectors, raising total collection costs.

But what really lowers the Filipino institution’s percentage servicing costs is the level of total balances, which is 10 times higher than in the Bangladeshi institution.

Servicing costs for savings products at Bangladeshi and Filipino institutions

	Bangladesh		Philippines	
	Annual cost in US \$	%	Annual cost in US \$	%
Total Servicing Costs	29,964	16.7%	29,543	1.8%
Collecting savings from clients	17,193	9.6%	15,473	1.0%
Processing of withdrawals	1,197	0.7%	10,514	0.6%
Issuing new & replacing pass book	176	0.1%	2,073	0.1%
Closing accounts	272	0.2%	1,483	0.1%
Other activities (e.g. collecting service charge, visiting clients, others)	11,127	6.1%	0	0.0%
Average Savings Balance (US\$)	22		150	

Average deposit balances per client (US \$150 in the Philippines versus US \$23 in Bangladesh) seem to indicate that more of the Bangladeshi institution’s clients are poor. However, the Philippines number is actually skewed by a few large depositors; the smallest 90% of its accounts have an average balance per account of only US \$29, while the other 10% has an average of \$ 1,426.

Reaching out to a relatively limited number of large savers thus enables the Filipino institution expand its deposits exponentially – bringing down the overall cost of deposits and subsidizing a relatively expensive service to small savers.

⁹ For more information, please see Annex 4.



Annex 4: Savings and Loan Products Activity Costs of the Bangladeshi Institution

Core Processes	Activities	Loan		Saving		All Products	
		Monthly Cost	% of Avg Bal	Monthly Cost	% of Avg Bal	Monthly Cost	% of Avg Bal
Opening Deposit Accounts	Explaining rules to clients	-	0.0%	12,259	1.4%	12,259	0.5%
Opening Deposit Accounts	Visiting clients' households	-	0.0%	2,856	0.3%	2,856	0.1%
Opening Deposit Accounts	Preparing account applications and passbooks	-	0.0%	1,823	0.2%	1,823	0.1%
Opening Deposit Accounts	Recording clients information	-	0.0%	879	0.1%	879	0.0%
Opening Deposit Accounts	All Activities	-	0.0%	17,817	2.0%	17,816.9	0.7%
Servicing deposit accounts	Collecting savings from clients	-	0.0%	85,963	9.6%	85,963	3.4%
Servicing deposit accounts	Processing of withdrawals	-	0.0%	5,985	0.7%	5,985	0.2%
Servicing deposit accounts	Visiting clients	-	0.0%	13,510	1.5%	13,510	0.5%
Servicing deposit accounts	Correcting incorrect records	-	0.0%	3,852	0.4%	3,852	0.2%
Servicing deposit accounts	Paying interest to clients	-	0.0%	-	0.0%	-	0.0%
Servicing deposit accounts	Issuing new passbook & replacing pass book	-	0.0%	882	0.1%	882	0.0%
Servicing deposit accounts	Collecting service charge	-	0.0%	38,270	4.3%	38,270	1.5%
Servicing deposit accounts	Closing accounts	-	0.0%	1,359	0.2%	1,359	0.1%
Servicing deposit accounts	All Activities	-	0.0%	149,822	16.7%	149,821.6	6.0%
Making Loans	Processing loan requests including checking clients	7,543	0.5%	-	0.0%	7,543	0.3%
Making Loans	Reviewing product rules eligibility	5,426	0.3%	-	0.0%	5,426	0.2%
Making Loans	Disbursing loans and recording the loans	7,531	0.5%	-	0.0%	7,531	0.3%
Making Loans	All Activities	20,500	1.3%	-	0.0%	20,500.3	0.8%
Servicing existing loan	Collecting repayment, fees & recording	74,266	4.6%	-	0.0%	74,266	3.0%
Servicing existing loan	Follow up delinquent clients	6,809	0.4%	-	0.0%	6,809	0.3%
Servicing existing loan	All Activities	81,075	5.0%	-	0.0%	81,075.1	3.2%
Handling cash transaction	Cash collection and record in	15,079	0.9%	15,070	1.7%	30,149	1.2%
Handling cash transaction	Disburse and record cash out	2,043	0.1%	2,043	0.2%	4,087	0.2%
Handling cash transaction	All Activities	17,122	1.1%	17,113	1.9%	34,235.3	1.4%



Sustaining Activities	Expansion and Promotion	1,788	0.1%	1,788	0.2%	3,575	0.1%
Sustaining Activities	Staff Meeting	10,007	0.6%	10,007	1.1%	20,015	0.8%
Sustaining Activities	Internal Control	16,279	1.0%	16,279	1.8%	32,559	1.3%
Sustaining Activities	HRM	5,636	0.4%	5,636	0.6%	11,272	0.5%
Sustaining Activities	Reporting and MIS	14,140	0.9%	14,140	1.6%	28,279	1.1%
Sustaining Activities	General Administration	13,117	0.8%	13,117	1.5%	26,234	1.0%
Sustaining Activities	External Relations	2,473	0.2%	2,473	0.3%	4,946	0.2%
Sustaining Activities	Performance Monitoring	8,464	0.5%	8,464	0.9%	16,928	0.7%
Sustaining Activities	All Activities	71,904	4.5%	71,904	8.0%	143,808.5	5.7%
<u>All Processes</u>	<u>All Activities</u>	<u>190,602</u>	<u>11.9%</u>	<u>256,656</u>	<u>28.6%</u>	<u>447,258</u>	<u>17.9%</u>