

Is There a Business Case for Small Savers?

For most of its history, microfinance has focused on credit. Savings, which are very important in helping poor people start a business, mitigate risks, and maintain at least a minimum level of consumption, has traditionally played a secondary role. In recent years, microfinance institutions (MFIs) have increasingly recognized the importance of savings and introduced savings products. Now, faced with growing competition, many MFIs are rethinking whether they can continue to provide the level of cross-subsidies they believe is required to serve the low end of the savings market, namely, the small savers.

With experience and data increasingly confirming that offering small savings accounts brings large numbers of savers to MFI branches, costs a great deal, and provides very little funding to the MFI, it is crucial to examine the true cost and profitability of small savers. In Westley and Martin (2010), we analyze quantitatively whether or not small savers—defined as the half of all savings clients of an MFI with the smallest deposit balances—contribute to or undermine the sustainability of the MFI.

In case studies of two MFIs, ADOPEM in the Dominican Republic and Centenary Bank in Uganda, we confirm that the savings accounts of small savers are a very high-cost product for MFIs to offer, with annual operating costs on a marginal cost basis of 59–241 percent of the deposit balances of the small savers in the study year of 2008. We obtain these high cost levels despite counting only *marginal* costs—that is, the costs that would actually be saved by eliminating small savers—as is appropriate (but often not recognized as such). This means, for instance, that no fixed costs are counted because they must be paid whether or not small savers are present. Fixed costs generally include, for example, much or all of the board of directors, management, and staff of central service departments (such as accounting, administration, audit, finance, legal, marketing, and personnel), as well as nonpersonnel costs associated with these personnel (e.g., rent for the space they occupy and the costs of the equipment, electricity, fuel, paper, and other things they use).

Although small savings accounts are found to have high operating costs, these costs are more than overcome by the profits generated through cross-sales of loans and other products to small savers and by the fee income derived from the savings accounts themselves. On balance, then, small savers

generate large profits—just over 400 percent of the small-saver deposit balances in Centenary and just over 1,000 percent in ADOPEM. Expressing this same result in a different way, without small savers, these two very profitable MFIs would lose about 30 percent of their total profits. We conclude, therefore, that based on this profitability analysis, there is a compelling business case for serving small savers in both Centenary and ADOPEM. Although we have calculated small-saver profits in only two MFIs, these MFIs have been carefully selected and suggest a number of important channels through which small savers may be a profitable, or even highly profitable, client segment.

To generalize from these two MFIs to others, it is useful to examine what makes small savers profitable in the two case studies. To this end, we have identified five sources of small-saver profits in ADOPEM and Centenary:

- **Loans.** Loans are an important source of small-saver profits in both MFIs, generating 91 percent of total small-saver profits in ADOPEM and 51 percent in Centenary. These large profits are the result, in both MFIs, of the facts that (i) lending in general (to all borrowers, not just small savers) is profitable and (ii) small savers are not small borrowers, as indicated by the fact that the average loan balance of small savers who borrowed was 61 percent and 74 percent of the average loan balance of all borrowers in Centenary and ADOPEM, respectively.
- **Other cross-sold products (besides loans and savings accounts).** In ADOPEM, the remaining 9 percent of total small-saver profits is generated from the sales of three life insurance products. In Centenary, 16 percent of total small-saver profits are derived from the sales of four essentially money transfer products.

- **Technology.** Automated teller machines (ATMs) help MFIs attract and retain clients and increase small saver savings, borrowing, and purchases of other products. Centenary makes substantial use of ATMs; for example, in 2008, 51 percent of small saver deposit and withdrawal transactions were made with ATMs. As a result of all these points, ATMs boosted Centenary's overall small-saver profits by 37 percent.
- **Higher loan rates for smaller and otherwise costlier-to-make types of loans.** If the loans taken out by small savers are smaller than average or costlier per dollar lent for other reasons, the MFI may be able to cover all its loan costs and even make this lending and small savers profitable by charging higher interest rates and/or fees for these loans. Because of both factors (smaller and otherwise costlier-to-make loans), Centenary charged small savers 5.8 percentage points more for loans than it charged borrowers overall (34.2 percent versus 28.4 percent). Without these 5.8 percentage points, almost exactly 100 percent of the profits from lending to small savers would have been lost.
- **Savings account fees.** If the cost of serving small savers is excessive even when the preceding four sources of profit are taken into account, the MFI always has the option to charge for the service provided. This is analogous to MFIs that want to be sustainable raising their lending rates, overall or for particularly costly subsets of borrowers. Centenary's savings account fees generate 33 percent of its total small-saver profits.

To these five pathways to small-saver profitability observed in ADOPEM and Centenary, we can add a sixth: the evolution of small savers to future profitability. Even if small-saver loans and savings accounts are too small today to make small savers profitable, both may increase in size over time by enough to make small savers profitable in future years. As a result, small savers may be worth serving today even on a strictly business basis so that the MFI can reap the rewards of serving them in future years. Employing data from ADOPEM, we find that the average size of small-saver savings accounts and loans has been growing very rapidly in recent years, a total of 105 percent and 83 percent, respectively, over the two-year period from the end of 2006 to the end of 2008.

Given all of these possible pathways to profitability—and taking into account the fact that the revenue derived from loans, other cross-sold products, and savings accounts need cover only marginal costs for these products to be considered profitable—our educated guess is that many MFIs are already profitably serving small savers and many more could do so.

Reference

Westley, Glenn D., and Xavier Martín Palomas. 2010. "Is There a Business Case for Small Savers?" Occasional Paper 18. Washington, D.C.: CGAP.

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